[DRAFT FOR CONSULTATION][1]

Completion Instructions
Return of Liquidity Position of an Authorized Institution
Form MA(BS)1E

INTRODUCTION

1. This document sets out the Completion Instructions (CIs) for authorized institutions (AIs) to compile the above Return. The Return is used by the HKMA to collect information from AIs on their liquidity ratios and related matters. This facilitates the ongoing supervision and monitoring of liquidity risk both of individual AIs and of the banking sector as a whole. This document should be read in conjunction with:

   (i) the Banking (Liquidity) Rules (BLR) [2], made by the Monetary Authority (MA) under the Banking Ordinance (BO) [3] to prescribe liquidity requirements applicable to AIs. The BLR set out the requirements relating to the Liquidity Coverage Ratio (LCR)[4] and the Liquidity Maintenance Ratio (LMR)[5]. The LCR is applicable to AIs designated by the MA as category 1 institutions under

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1 Most of the footnotes provided in this draft are for explanatory purposes, and will be deleted after this set of Completion Instructions is finalised.

2 The HKMA issued to the industry for statutory consultation on 15 August 2014 a draft set of BLR to be made under section 97H of the Banking Ordinance and a draft CoP (see Footnote 6) to be issued under section 97M of the Ordinance. The reporting requirements presented, and the terms used, in this draft Return largely reflect those included in the draft BLR and CoP. In finalising this Return, the HKMA will take into account industry comments received from the consultation and incorporate changes, where necessary, to align with the final drafting of the BLR and CoP.

3 The existing provisions in the BO relating to the Liquidity Ratio (mainly set out in Part XVIII and the Fourth Schedule) will be repealed when the new liquidity requirements (mainly set out in Part XVIB as inserted by the Banking (Amendment) Ordinance 2012 (BAO 2012)) come into effect on 1 January 2015.

4 The LCR is one of the two Basel III liquidity standards introduced by the Basel Committee on Banking Supervision (BCBS) in response to the 2007-2009 Global Financial Crisis. The detailed LCR requirements are set out in the document *Basel III: Liquidity Coverage Ratio and liquidity risk monitoring tools* issued by the BCBS in January 2013, which is available at *http://www.bis.org/publ/bcbs238.pdf*. This document is referred to as the 2013 BCBS LCR Document in these CIs. The HKMA has conducted 3 rounds of consultation on *Implementation of Basel III Liquidity Standards in Hong Kong* during 2012 and 2013. The relevant consultation papers (L1, L2, L3) are available at:

- L1: *http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/basel-3/consultation_on_basel-3_implementation_b/consultation_paper_liquidity.pdf*
- L2: *http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/basel-3/basel3-20120618/consultation_paper_liquidity.pdf*
- L3:*http://www.hkma.gov.hk/eng/key-functions/banking-stability/basel-3/consultation_on_local_implementation_of_basel-3_liquidity_standards.shtml*

5 The LMR is an enhanced version of the Liquidity Ratio set out in Part XVIII of, and the Fourth Schedule to, the BO. The LMR was previously referred to as the Modified Liquidity Ratio (or MLR) in the HKMA's consultation papers (L1, L2, L3) referred to in Footnote 4.

section 4 of the BLR, whereas the LMR is applicable to other AIs that are not designated as category 1 institutions (i.e. category 2 institutions);

(ii) the Banking (Liquidity Coverage Ratio – Calculation of Total Net Cash Outflows) Code (CoP) issued by the MA under section 97M of the BO for the purposes of providing guidance on the calculation of "total net cash outflows", the denominator of the LCR;[6]

(iii) the statutory guideline *Liquidity Risk Management* (LM-1) [7] issued by the MA under the Supervisory Policy Manual (SPM), which sets out the HKMA's approach to supervising AIs' liquidity risk and provides supplementary guidance to AIs in respect of the LCR or LMR requirements applicable to them under the BLR; and

(iv) the statutory guideline *Sound Systems and Controls for Liquidity Risk Management* (LM-2) under the SPM, which sets out the HKMA's supervisory expectations on AIs' liquidity risk management systems.

The terms used in this Return should, unless specified otherwise or the context requires otherwise, be ascribed to the meanings used in the BO, the Banking (Capital) Rules (BCR), BLR or CoP, as the case may be.

2. This Return consists of 3 parts:

(i) Part 1 summarises certain key information relating to the reporting institution's liquidity ratio. Most of the items in this Part are automatically generated from information reported in other Parts of the Return.

(ii) Part 2 captures relevant information pertaining to the calculation of the LCR. This Part should be completed by all category 1 institutions.

(iii) Part 3 captures relevant information pertaining to the calculation of the LMR. This Part should be completed by all category 2 institutions.

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6 Owing to some technical complexity in the determination of "total net cash outflows" for the purposes of the LCR, the HKMA has elected at this stage to use a CoP to elaborate on the technical aspects of the calculation.

7 The HKMA is updating the SPM modules LM-1 and LM-2 to incorporate, and elaborate on, the requirements in the BLR and CoP relevant to the implementation of the LCR and the LMR. The industry will be consulted on the proposed revisions of these modules in due course.

~~(iv) Part 4 captures certain supplementary information related to the LCR or LMR. All AIs should complete this Part.~~[8]

3. This Return is supplemented by the following returns, which are, or will be, used by the HKMA to collect other liquidity-related information from AIs:

	Reported by	Reporting bases	Reporting frequency
MA(BS)18 – Return on Selected Data for Liquidity Stress-testing[9]	All licensed banks incorporated in HK	Unconsolidated position (HK Office and overseas branches, if any)	Quarterly
MA(BS)22 – Return on Intraday Liquidity Position of an Authorized Institution [10]	All licensed banks incorporated in HK (and any other AIs designated by HKMA)	Same as MA(BS)1E (initially HK office only until further advice)	HK Office: Monthly Other bases: to be determined
MA(BS)23 – Return on Liquidity Monitoring Tools [11]	All AIs	Same as MA(BS)1E	Quarterly (initially for 2015)[12]

8 The HKMA proposes to delete Part 4 of this Return in an effort to reduce AIs' reporting burden in implementing the new reporting requirements.

9 The HKMA will review MA(BS)18 in due course to determine whether it should be modified or enhanced for the purposes of liquidity stress-testing.

10 The new Return of Intraday Liquidity Position of an Authorized Institution MA(BS)22, on which the industry was consulted in Q2 2014, was introduced to implement the BCBS Guidance on Intraday Liquidity Monitoring Tools issued in April 2013.

11 The new Return on Liquidity Monitoring Tools [MA(BS)23], on which the industry was consulted in Q2 2014, is introduced to implement the liquidity monitoring tools recommended by the BCBS in the 2013 BCBS LCR Document.

12 To enable a smoother transition to the new reporting requirements under MA(BS)23, the HKMA proposes to extend the frequency for submitting this Return from monthly (as originally proposed) to quarterly in the year 2015. The need for any continuation of this transitional arrangement after 2015 will be reviewed over the course of 2015.

GENERAL INSTRUCTIONS

Bases of reporting

4. All AIs (irrespective of their place of incorporation) must calculate the LCR or the LMR, as the case may be, on a Hong Kong office basis[13]. AIs incorporated in Hong Kong must additionally calculate the LCR or LMR on the following bases where applicable[14]:

   (i) Unconsolidated basis, covering the AI's Hong Kong office and overseas branches (if any); and

   (ii) Consolidated basis (if the AI has one or more than one associated entity[15]), covering the AI's Hong Kong office, overseas branch(es), and any associated entity specified by the MA on a case-by-case basis.[16]

   To avoid doubt, references in this Return to an AI incorporated in Hong Kong, in terms of reporting of the LCR or LMR on a consolidated basis, should also be construed in the context of the AI's consolidated group[17].

Reporting frequency and submission timeline

5. A reporting institution should submit this Return (i.e. a separate copy of this Return for each basis of calculation applicable to it) to the MA not later than 14 days after the last day of each calendar month (i.e. the month-end reporting date). [18] If the submission date falls on a public holiday, it will be deferred to the next working day.

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[13] The term "Hong Kong office" refers to an AI's principal place of business in Hong Kong and its local branches (if any).

[14] Section 97H(3)(d) and (e) of the BO enables the MA to require an AI incorporated in Hong Kong to calculate the LCR or LMR on a combination of specific reporting bases. For example, in addition to the reporting bases specified in this paragraph, the MA may require an AI to calculate the LCR or LMR covering its operations in a particular jurisdiction separately. The imposition of any other such reporting basis will only be required when the MA envisages a genuine need therefor having regard to the AI's liquidity risk profile.

[15] The term "associated entity" is defined in section 97H(4) of the BO (as inserted by the BAO 2012).

[16] The HKMA is undergoing bilateral discussions with AIs incorporated in Hong Kong on the scope of consolidation in the calculation of LCR or LMR, having regard to the level of liquidity risk that their associated entities may pose to them; and whether the business of those entities falls within one or more than one "relevant financial activity" (which is defined in the BLR largely following the existing definition provided in the BCR).

[17] Under the BLR, the consolidated group of an AI which is incorporated in Hong Kong covers the AI's Hong Kong office, overseas branches (if any), and specified associated entities (if any).

[18] Under the Basel LCR standard, banks are required to report their LCR on a consolidated basis to supervisory authorities within 14 days after each month-end. The HKMA intends to adhere to this requirement. For

6. In each monthly submission, the reporting period covered in this Return refers to the calendar month ending on the month-end reporting date.

Valuation of assets, liabilities or cash flows under LCR or LMR

7. Unless otherwise specified, all asset, liability and cash-flow items included in the calculation of the LCR or LMR should be measured on the basis of their "principal amount" as defined in the BLR. The "principal amount" of any marketable asset included as a "high quality liquidity asset" (HQLA) under the LCR or "liquefiable asset" under the LMR should be measured at fair value[19]. The principal amount of other on-balance sheet assets and liabilities and associated cash flows should be the book value (including any accrued interest [20]) as determined according to the applicable accounting standards. For off-balance sheet items, the principal amount means the contracted amount or, in the case of an undrawn or partially drawn facility, the undrawn amount.

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consistency's sake, the HKMA will also adopt this submission timeline for the reporting of the LMR. Nevertheless, similar to the reporting of MA(BS)23, the HKMA proposes to adopt the following transitional arrangements for AIs' reporting of MA(BS)1E in the year 2015:

(i) An AI is allowed to submit this Return on the Hong Kong office basis within 21 calendar days after the end of each month.

(ii) If an AI incorporated in Hong Kong is also required to submit this Return on an unconsolidated basis, consolidated basis or any other basis specified by the MA under section 13(1) of the BLR (or any combination of these reporting bases), the AI should submit this Return on such basis or bases as applicable within one calendar month after the end of each month.

The above arrangements will be reviewed over the course of 2015.

[19] Footnote 11 of the 2013 BCBS LCR Document specifies that "*Level 1 assets in the stock of HQLA should be measured at an amount no greater than their current market value*". Paragraphs 52 and 54 of this Document also provide that Level 2A assets or Level 2B assets (which are all marketable debt securities) must be measured at "current market value". Accordingly, the HKMA considers that marketable assets included as HQLA under the LCR should be measured at fair value. For consistency's sake, the same principle is applied to marketable assets included as "liquefiable assets" under the LMR.

[20] According to the definition of "principal amount" provided in section 2(1) of the BLR, if the principal amount of an on-balance sheet item is not measured at fair value, then the principal amount of this item means its book value including accrued interest. The term "accrued interest" means the amount of interest accrued on an asset, liability or cash flow up to the position date of the LCR or the LMR. (To avoid doubt, if the principal amount of an on-balance sheet item is measured at fair value, it is not necessary to add accrued interest to the reported principal amount.)

Apart from "accrued interest" that needs to be added to the book value of an on-balance sheet item, interest to be accrued on such an item within the LCR period or the LMR period as referred to in paragraph 10 of this Return (i.e. interest receivable or payable by the reporting institution within the relevant period) should also be included in the calculation of the LCR or LMR. The treatment of interest receivable or payable differs across individual reporting items under the LCR or LMR. Please refer to specific CIs for relevant items under the two ratios.

Reporting currencies

8. Unless specified otherwise, the figures to be reported in this Return should be rounded up to the nearest thousand in Hong Kong dollars (HKD), or HKD equivalent in the case of foreign currency items. The closing middle market T/T rates prevailing at the close of business on the position date should be used for conversion purposes.

9. Reporting institutions are required to provide a breakdown of the reported amount of individual components of the LCR or LMR in the following currencies:[21]

Components of LCR	Components of LMR
• Hong Kong dollars (HKD) • US dollars (USD) • Major currencies (including euro (EUR), Japanese yen (JPY) and pound sterling (GBP)) • renminbi (RMB) • other currencies*	• Hong Kong dollars (HKD) • US dollars (USD) • renminbi (RMB) • other currencies*

* If a reporting institution has significant exposure to any specific currency within the "other currencies" category, the institution should put in place adequate systems and procedures to ensure its ability to provide the relevant breakdown of the LCR / LMR components in that currency upon request by the HKMA. A currency is considered to be significant to an AI if the AI's liabilities denominated

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[21] The existing Return requires reporting institutions to provide a breakdown of the weighted amount of each asset or liability component of the Liquidity Ratio into (i) "HKD plus USD", and (ii) other currencies. In the revised Return, reporting institutions will be required to provide a more granular breakdown of the LCR / LMR components in the following currencies:

- HKD, USD and RMB (for all AIs) – A separate breakdown in these currencies is considered necessary for more effective monitoring of AIs' liquidity positions in these currencies. This is in recognition of the relative importance of these currencies to the Hong Kong banking sector and the relatively large (or increasingly large) positions of AIs in these currencies. In the case of RMB, the reported information will also facilitate supervisory monitoring by the HKMA of AIs' RMB liquidity profile amid continuing development of RMB business in Hong Kong;

- EUR, JPY and GBP (for category 1 institutions only) – Those institutions that need to use Option 2 of the Alternative Liquidity Approaches ("ALA Option 2") under the LCR will be subject to foreign exchange haircuts for HQLA denominated in foreign currencies that will be used to cover their HKD liquidity needs under this Option (re section 39 of the BLR). As explained in L3 (section 5), EUR, JPY and GBP fall within the category of "other major currencies". HQLA denominated in a currency within this category will be subject to an 8% haircut under ALA Option 2, while HQLA denominated in USD will be subject to a 2% haircut (in light of the Linked Exchange Rate Mechanism) and HQLA denominated in other convertible currencies (including RMB) will be subject to a 10% haircut.

The calculation of foreign exchange haircuts under ALA Option 2 for LCR purposes is automated in Part 2, Section (II), Table 2 of this Return based on data reported by a category 1 institution in that Part. The method of calculation is illustrated in **Annex 1** to this Return.

in that currency account for 5% or more of its total liabilities (including shareholders' funds).[22]

Time horizon of LCR and LMR

10. The LCR of a category 1 institution is calculated based on a time horizon of 30 calendar days (the "LCR period"). For the purposes of calculating the LCR at a specific position date, the LCR period refers to the 30 calendar days immediately following that date. The LMR of a category 2 institution is calculated based on a time horizon of one calendar month (the "LMR period"). For the purposes of calculating the LMR at a specific position date, the LMR period refers to the calendar month immediately following that date.

Determination of "remaining term to maturity"

11. In determining whether the maturity date of an asset, liability or cash-flow item is expected to fall within the LCR period or the LMR period, reference should be made to its contractual terms unless otherwise specified. If there are options for prepayment or deferred payment embedded in the contractual terms that may alter the contractual maturity date of an asset, liability or cash-flow item, for the purposes of determining its remaining term to maturity (or its earliest possible maturity date) under the LCR or LMR, the reporting institution should adopt the following approach[23]:

    (i) If the reporting institution's counterparty has an option to defer payment in relation to an asset (or a cash inflow arising from the asset) to the institution beyond the LCR period or LMR period, the institution should assume that the option will be exercised and should not count the asset (or the cash inflow) in the LCR or LMR. If however the institution has an option to advance payment in relation to an asset (or a cash inflow arising from the asset) from its counterparty within the LCR period or LMR period, it should assume that the

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[22] The benchmark of "5% of total liabilities" is set by reference to paragraph 211 of the 2013 BCBS LCR Document. The HKMA considers that this benchmark should be applicable to both category 1 institutions and category 2 institutions in determining whether they have significant exposure to a specific currency. This benchmark should be measured on the basis of (i) the "total liabilities" figure reported in item 11 of the most recent "Return of Assets and Liabilities" submitted by the reporting institution to the HKMA, i.e. MA(BS)1A for Hong Kong office position and MA(BS)1B for unconsolidated position; or (ii) the latest available figure of consolidated total liabilities (including shareholders' funds) published by the institution if it needs to submit this Return on a consolidated basis.

[23] This approach is in line with the principles in the 2013 BCBS LCR Document (paragraphs 86 and 87). Although these principles are set out in the 2013 BCBS LCR Document primarily for unsecured wholesale funding under the LCR, the HKMA observes that it is not uncommon for AIs to use the same approach for determining the term to maturity of their assets and liabilities in the course of internal liquidity management and stress-testing. Therefore the HKMA intends to make the approach more generally applicable for the purposes of calculating the LCR and LMR.

option is not exercised, unless the institution has actually notified its counterparty that it will exercise the option.

(ii) If the reporting institution or its counterparty has an option to advance payment in relation to a liability (or a cash outflow arising from the liability) to the counterparty such that the payment date falls within the LCR period or LMR period, the institution should assume that the option will be exercised and should count the liability (or the cash outflow) in the LCR or LMR.[24] If however the institution has an option to defer payment in relation to a liability (or a cash outflow), it should assume that the option is not exercised, unless the institution has actually notified its counterparty that it will exercise the option.

No double counting of reported items

12. Any asset, liability or cash-flow item included in the calculation of the LCR or LMR for reporting in this Return should not be double counted. For example,

(i) in the case of the LCR, if an asset is included in the reporting institution's HQLA (numerator), any cash inflow associated with the asset (e.g. arising from the maturity of the asset within the LCR period) cannot be included in the institution's total net cash outflows (denominator). Similarly, in the case of the LMR, an asset included in the institution's liquefiable assets (numerator) cannot be deducted from the institution's qualifying liabilities (denominator) even if the asset is due to mature within the LMR period; and

(ii) where a liability or funding obligation of the reporting institution arising from a transaction can potentially be included in more than one type of expected cash outflow under the LCR (or qualifying liability under the LMR), it is not necessary for the institution to include such liability or obligation in the calculation of each and every applicable type of expected cash outflow under the LCR (or qualifying liability under the LMR), provided that the outflow treatment will yield the maximum amount of expected cash outflow for such liability or obligation under the LCR (or qualifying liability under the LMR), save for situations where a specific outflow treatment is clearly prescribed in the BLR.[25]

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[24] This treatment takes into account the possible interaction between an AI and its creditors. For example, if the liability of an AI is callable at its discretion (e.g. in the case of a debt security issued by the AI) and the market expects the AI to exercise the option, there may be a case for assuming that the AI will indeed exercise the option for reputation reasons (otherwise the market may perceive the AI as having liquidity problems).

[25] Ref: 2013 BCBS LCR Document (paragraph 72)

SPECIFIC INSTRUCTIONS

PART 1: SUMMARY CERTIFICATE ON LIQUIDITY POSITION

Section (I) : Summary of information on Liquidity Coverage Ratio

13. If the reporting institution is a category 1 institution, complete item 1.8 (*the lowest LCR during the reporting period*) and item 1.9 (*the lowest level of HKD level 1 assets as a percentage of HKD total net cash outflows (before application of 75% inflow ceiling) during the reporting period*). The other information included in this Section will be generated automatically from that reported by the institution in Part 2 of this Return.

    Item 1.8 enables the HKMA to monitor whether a category 1 institution complies with the minimum level of LCR required under section 5 of the BLR during the reporting period.

    Item 1.9 enables the HKMA to monitor whether a category 1 institution, which needs to use HQLA denominated in foreign currencies to cover the institution's HKD LCR mismatch[26] (i.e. ALA Option 2), complies with the requirement in section 38(d) of the BLR that it holds at least an amount of HKD-denominated level 1 assets that is not less than 20% of its HKD-denominated total net cash outflows (before application of the 75% inflow ceiling) during the reporting month. For the purposes of this item, the amount of HKD-denominated level 1 assets should be calculated net of applicable haircuts but before adjustments of the 15% ceiling on level 2B assets and 40% ceiling on level 2A and level 2B assets. Please refer to the explanatory note provided under item A6 in Section (I) under Part 2 of this Return and **Annex 1** for further details of the ALA mechanics.

For example, a category 1 institution has arranged a structured financing transaction (e.g. an asset-backed commercial paper issuance programme) via a special purpose entity (SPE) and the institution has provided a committed liquidity facility to the SPE or any associated entity (say, in order to cater for the possible needs for the SPE to redeem the structured financial instrument issued under that transaction or to support an associated entity to act as a market-maker for the instrument). If the financial instrument issued by the SPE will mature within the LCR period and therefore the expected cash outflow arising from the redemption of the instrument is reported in item B17 of Section (I) under Part 2 of this Return, the institution does not need to report the committed liquidity facility associated with this structured financing transaction under item B19 or item B21 of Section (I) under Part 2 of this Return.

[26] Under the BLR, the term "HKD LCR mismatch" refers to that portion of a category 1 institution's total HKD-denominated net cash outflows (before application of the 75% inflow ceiling) that is not covered by its HKD-denominated HQLA (before making any adjustment in respect of the 40% ceiling on level 2A assets and level 2B assets and the 15% ceiling on level 2B assets).

Section (II) : Summary of information on Liquidity Maintenance Ratio

14. The information in this Section will be generated automatically from that reported by the reporting institution (if the institution is a category 2 institution) in respect of its LMR position in Part 3 of this Return.

PART 2: LIQUIDITY COVERAGE RATIO

General requirements for reporting of LCR[27]

Inclusion of assets as HQLA

15. The reporting institution should only report in its stock of HQLA any asset that fulfils the following requirements:

    (i) the asset falls within a class of assets specified in Schedule 2 to the BLR and meets the qualifying criteria applicable to that class of asset as specified in the Schedule;

    (ii) the asset satisfies the characteristic requirements specified in Schedule 3 to the BLR, and the operational requirements specified in Schedule 4 to the BLR that are applicable to the asset;

    (iii) the institution satisfies the operational requirements specified in Schedule 4 to the BLR that are applicable to the institution in so far as those requirements relate to the asset.[28]

16. If an asset held by the reporting institution is eligible for inclusion as HQLA and the asset is due for redemption within the LCR period, report the asset as HQLA instead of as a cash inflow. If, however, the asset no longer qualifies as HQLA, report the asset as a cash inflow (measured at book value, including accrued interest) plus any interest receivable upon redemption.[29] To avoid doubt, any asset lent by the institution to a third party (or borrowed from a third party) on an uncollateralized basis (e.g. the asset lending or borrowing transaction is not conducted under a repo-style transaction) cannot be counted as the institution's HQLA in any circumstance.[30]

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27 These are requirements generally applicable to more than one reporting item, whether within the same section or across different sections of the LCR reporting templates.

28 The BLR contain some Schedules to specify the eligible classes of assets and respective qualifying criteria, the characteristic requirements, and the operational requirements that must be fulfilled by the relevant assets (or by the category 1 institution concerned in respect of operational requirements applicable to the institution that relate to the assets) for those assets to be included in the institution's HQLA. The HKMA will provide further guidance in LM-1 (which is being modified) regarding the manner in which category 1 institutions are expected to fulfil the relevant requirements.

29 Ref: "*Frequently Asked Questions on Basel III's January 2013 Liquidity Coverage Ratio framework*" published by the BCBS in April 2014 (BCBS LCR FAQ (April 2014), no. 19) http://www.bis.org/publ/bcbs199.pdf)

30 Ref: BCBS LCR FAQ (April 2014), no. 16

17. Pursuant to sections 24 and 25 of the BLR, if the reporting institution is incorporated in Hong Kong, the HQLA held by an overseas branch or specified associated entity[31] of the reporting institution must be included under Section (I)A of this Part for the calculation of the institution's LCR on a consolidated basis, unconsolidated basis and/or other basis specified by the MA under section 13 of the BLR (where applicable) only to the extent that the total net cash outflows of the branch or entity are also included in Section (I)B of this Part (irrespective of whether the HQLA are subject to liquidity transfer restrictions[32]).

18. If however the amount of HQLA held by the branch or entity is more than the institution is required to hold by prevailing regulations applicable to it, any such surplus HQLA included in Section (I)(A) of this Part must meet the conditions set out in section 24(1)(b) of the BCR, including (i) the free transferability at all times of the surplus HQLA to other parts of the institution or its consolidated group; and (ii) the absence of any liquidity transfer restriction affecting, or of any reasonable doubt about, the free transferability of the surplus HQLA.

Determination of risk-weights for marketable debt securities

19. For the purposes of reporting the amount of marketable debt securities[33] under sub-items A1(c), A1(d), A1(e) and A2(a) in Section (I) of this Part, the risk-weights applicable to those debt securities are to be determined under the standardized (credit risk) approach (STC Approach) prescribed in the following sections under Part 4 of the BCR[34]:

<u>Marketable debt securities issued or guaranteed by:</u>	<u>Applicable provisions in BCR for determining the risk-weight:</u>
● Sovereigns or central banks	● Section 55(2)
● Public sector entities	● Section 57(2)(b)
● Relevant international organizations	● Section 56(4)
● Multilateral development banks	● Section 58

31 Under the BLR, the term "specified associated entity" refers to an associated entity of an AI which is required by the MA to be included in the calculation of the AI's LCR or LMR on a consolidated basis.

32 Under the BLR, the term "liquidity transfer restriction" refers to any regulatory, legal, tax, accounting or other restriction or impediment that inhibits, or may potentially inhibit, the transfer of assets or the flow of funds between an AI's Hong Kong office and any of its associated entities and overseas branches.

33 The term "debt securities" is defined in the BLR as referring to any securities other than (a) equities; (b) securities that can be converted into equities; or (c) import or export trade bills.

34 As required in the 2013 BCBS LCR Document (Footnote 15), the 0% risk-weight applicable to level 1 assets cannot be determined by national discretion under the STC Approach (as provided in paragraph 53 the Basel II document "*International Convergence of Capital Measurement and Capital Standard*", which is available at: http://www.bis.org/publ/bcbs128.pdf). The same principle applies to the 20% risk-weight applicable to level 2A assets.

For LCR purposes, EF debt securities are to be treated as if they were issued by a central bank (i.e. determining the risk-weight under section 55(2) of the BCR).[35]

Reporting of net positions in marketable debt securities

20. Generally speaking, a marketable debt security reported as HQLA by the reporting institution should be net of the institution's short position in that security. If the institution is carrying a net short position in a security, no long position in that security should be reported as HQLA. Instead, the institution should report the net short position as a cash outflow under item B22 in Section (I) of this Part.[36]

21. If the reporting institution is a market maker for EF debt securities, determine and report its net position in these debt securities in accordance with the following:

(i) the long and short positions of such debt securities with a remaining term to maturity of not more than one year should be offset against one other;

(ii) the long and short positions of such debt securities with a remaining term to maturity of more than one year should similarly be offset against one other;

(iii) if the net positions in both (i) and (ii) above are long, they should be reported in the relevant asset item – see CIs for sub-items A1(c) and A1(d) in Section (I) of this Part;

(iv) if the net positions in (i) and (ii) are in the opposite direction (i.e. one is long and the other is short), the long position should be reduced by the short

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35 For LCR purposes, the term "EF debt securities" covers Exchange Fund Bills, Exchange Fund Notes or other debt securities (if any) that may be issued by the HKSAR Government (the "Government") for the account of the Exchange Fund.

For capital calculation purposes, EF debt securities are assigned a risk-weight of 0% pursuant to section 56(1) of the BCR. This provision is based on national discretion offered in paragraph 53 of the Basel II document. For LCR purposes, the risk-weight of EF debt securities is however determined according to section 55(2) (instead of section 56(1)) of the BCR) in the light of Footnote 15 of the 2013 BCBS LCR Document. EF debt securities can be reported in sub-item A1(c), being entitled to 0% risk-weight under section 55(2) of the BCR.

36 For example, if a category 1 institution has the following positions in debt securities which are eligible for recognition as HQLA (but not being EF debt securities, which are subject to the CIs provided in paragraph 21):

	Long	Short	Net Long (Net Short)
Debt Security A	$900	$300	$600
Debt Security B	500	750	(250)

The institution may recognise $600 net long position in Debt Security A as HQLA. The net short position ($250) in Debt Security B is actually an uncovered short position and hence should be reported as cash outflow under item B22 in Section (I) of this Part.

position on a dollar-for-dollar basis. The resultant net long position, if any, should then be reported in the appropriate asset item. (Note: As a contractual requirement, market makers of EF debt securities are not allowed to carry a net short position in these securities.)

Transactions with obligations for delivery of collateral

22. If the reporting institution has entered into a transaction whereby the institution has an obligation to deliver an amount of assets as collateral to the counterparty by selecting from a list of allowable assets, and the institution has not actually decided what type of asset is to be delivered, the institution should, for the purposes of calculating the expected cash outflow arising from this obligation to deliver collateral to the counterparty for reporting in this Part, assume that it would select assets within the allowable list in a descending order of the level of haircut applicable to the assets in the allowable list. If the allowable list contains the following types of asset, the order of selection would be – [37]

    1st: assets that do not qualify as HQLA;
    2nd: level 2B assets that are not approved RMBS;
    3rd: approved RMBS;
    4th: level 2A assets; and
    5th: level 1 assets.

23. If the allowable list includes assets denominated in different currencies and the reporting institution has not actually decided which asset is to be delivered, the institution may, for the purpose of completing the currency-specific columns in the templates, assume to deliver the asset in the following order:

    1st: assets denominated in "other currencies";
    2nd: assets denominated in RMB;
    3rd: assets denominated in "other major currencies" (i.e. EUR, JPY and GBP);
    4th: assets denominated in USD; and
    5th: assets denominated in Hong Kong dollar. [38]

24. In the case of a securities swap transaction where the reporting institution's counterparty is also obliged to deliver an asset to the institution by selecting from a list of allowable assets, the above assumptions on selection of assets is also applicable to the institution's counterparty. (Please refer to the CIs for items B9 and C3 in Section (I) of this Part.)

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[37] Ref: BCBS LCR FAQ (April 2014), no. 1(c)

[38] The specification of this order is aimed to avoid uncertainty that may be encountered by the reporting institution in completing the currency-specific columns.

Cash flows arising from transactions awaiting settlement

25. Cash flows arising from transactions awaiting settlement within the LCR period or forward contracts should be treated under the LCR according to the CIs provided in **Annex 2**.[39]

Pledged deposits[40]

26. A pledged deposit placed with the reporting institution by a customer (other than a bank) that is contractually pledged to the institution as collateral to secure a loan from the institution may be excluded from the institution's total expected cash outflows to be reported under Section (I)B of this Part, provided that the following conditions are met:

    (i) the loan will not be settled within the LCR period;
    (ii) the pledge arrangement is subject to a legally enforceable contract that effectively disallows withdrawal of the deposit before the loan is fully settled; and
    (iii) the amount of deposit to be excluded does not exceed the outstanding balance of the loan.

27. The above reporting treatment does not apply if the pledged deposit is pledged as collateral against an undrawn credit facility, in which case the reported amount of expected cash outflow that relates to that deposit or facility should be calculated based on the higher of the outflow rates that are respectively applicable to the deposit or facility as if the deposit were not a pledged deposit.

28. If a pledged deposit is pledged as collateral against a partially drawn credit facility –

    (i) the reporting treatment under paragraph 26 applies to the drawn portion of the facility; and
    (ii) the reporting treatment under paragraph 27 applies to the undrawn portion of the facility.

Deposits taken by deposit-taking companies

29. Where the reporting institution (or its specified associated entity) is a deposit-taking company (DTC), the reporting of deposits taken by the DTC under Section (I)B of this Part should follow the CIs set out in **Annex 4**.

Specific requirements for reporting of LCR

[39] Ref: BCBS LCR FAQ (April 2014), no. 15

[40] Ref: BCBS LCR FAQ (April 2014), no. 5

Section (I): Liquidity Coverage Ratio (Month-end position)

30. In this section, a category 1 institution should report the components of its LCR based on the position as at the month-end reporting date in accordance with the CIs set out below. The haircut applicable to each HQLA item, outflow rate applicable to each cash outflow item, and inflow rate applicable to each cash inflow item, are specified as "weights" under Column 4 of the reporting templates in Section (I)A, (I)B and (I)C of this Part respectively. The reporting institution should apply these "weights" for calculating the weighted amounts of HQLA, total expected cash outflows and total expected cash inflows for the purposes of reporting the LCR under this Return.

Section (I)
Ref no.

A. High quality liquid assets

Assets reported as HQLA by the reporting institution should meet all relevant qualifying requirements referred to in paragraph 15, and other applicable requirements set out in paragraphs 16 to 21, of these CIs.

A1 Level 1 assets

A1(b) Withdrawable central bank reserves

Report in this sub-item the book value (including accrued interest) of any funds placed by the reporting institution with the MA for the account of the Exchange Fund that are repayable on demand; and any of the following funds placed by the reporting institution with a central bank whereby the funds are –

(i) repayable on demand;

(ii) term funds that are explicitly and contractually repayable on notice (which expires on the first day of the LCR period) from the institution; and

(iii) term funds against which the institution can borrow from the central bank a loan on a term basis (or on an overnight but automatically renewable basis). If the amount of the loan that the institution may borrow from the central bank against the term funds concerned and the amount of the funds are different, report the lower of those two amounts.

If the reporting institution carries on a banking business in an overseas jurisdiction which is subject to reserve requirements imposed by the central bank in that jurisdiction, the reserves placed with the central bank may be reported in this sub-item only if –

(i) the reported amount is the portion of funds placed with the central bank that exceeds minimum reserve requirements and hence is repayable on demand; or

(ii) the reported amount is the portion of the required reserves that is allowed by the central bank to be drawn down by the institution in times of financial stress. This should be supported by an official policy document (or a notice) issued by the central bank or relevant banking supervisory authority (as discussed and agreed with the central bank) of the jurisdiction confirming the extent to which required reserves placed by banks are able to be withdrawn in times of stress.

RMB funds placed with the reporting institution's RMB Fiduciary Account opened with the People's Bank of China through the RMB Clearing Bank can be regarded as funds placed with an overseas central bank and hence be reported in this sub-item, subject to the funds meeting the relevant qualifying requirements. (Please refer to Part 7 and Schedules 2 to 4 of the BLR for the details of the relevant qualifying requirements.)

A1(c) to (e) Marketable debt securities reocngised as level 1 assets

A1(c) Report in this sub-item the fair value of marketable debt securities that comply with the requirements specified in Schedule 2 (section 1(c) in Part 1 and section 1 in Part 2) of the BLR. In particular, these debt securities must be issued or guaranteed by a sovereign, central bank, public sector entity, relevant international organization or multilateral development bank, or that are EF debt securities, and qualify for a risk-weight of 0% under Part 4 (STC approach) of the BCR[41].

A1(d) Report in this sub-item the fair value of marketable debt securities that comply with the requirements specified in Schedule 2 (section 1(d) in Part 1 and section 2 in Part 2) of the BLR. In particular, these debt securities must be issued by the sovereign or central bank of a jurisdiction, or that are EF debt securities, and which –

(i) do not qualify for a 0% risk-weight under Part 4 (STC approach) of the BCR (i.e. section 55(2)) (hence do not qualify for inclusion in sub-item A1(c); but

41 As noted in paragraph 19, the BCR provisions are section 55(2) (in the case of sovereigns or central banks); section 57(2)(b) (in the case of public sector entities); section 56(4) (in the case of relevant international organizations); and section 58 (in the case of multilateral development banks).

(ii) qualify for a 0% risk-weight only by virtue of section 56(1) or (2) of the BCR (being debt securities denominated in the local currency of the jurisdiction), provided that the institution is incorporated, or carries on a banking business through a branch or subsidiary, in the jurisdiction.[42]

A1(e) Report in this sub-item the fair value of marketable debt securities that comply with the requirements set out in Schedule 2 (section 1(e) in Part 1 and section 3 in Part 2) of the BLR. In particular, these debt securities must be issued by the sovereign or central bank of a jurisdiction and meet the criteria set out for item A1(d) except that the debt securities are denominated in a currency that is not the local currency of the jurisdiction in which the reporting institution is incorporated or carries on a banking business through a branch or subsidiary. The amount of debt securities reported in this sub-item should not exceed the amount of total net cash outflows in the non-local currency (in which the debt securities are denominated) arising from the institution's banking business in the jurisdiction.[43]

A2 Level 2A assets

A2(a) Report in this sub-item the fair value of marketable debt securities that comply with the requirements set out in Schedule 2 (section 2(a) in Part 1 and section 4 in Part 2) of the BLR. In particular, these debt securities must be issued or guaranteed by a sovereign, central bank or public sector entity, and which qualify for a 20% risk-weight under Part 4 (STC approach) of the BCR[44], but which do not qualify for inclusion as level 1 assets in sub-item A1(d) or A1(e)[45].

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42 For example, if the reporting institution is incorporated in jurisdiction A or maintains a branch or an associated entity in jurisdiction A, the institution can recognise a non-0% risk-weight debt security issued by the sovereign or central bank in jurisdiction A in its local currency as a level 1 asset under this sub-item, provided that other qualifying criteria are met. If the institution's branch or associated entity ceases to operate in jurisdiction A, the debt security concerned will no longer be eligible for recognition as a level 1 asset under this sub-item. In this situation, whether the debt security can be recognised as HQLA under another asset class (e.g. as a level 2A asset under sub-item A2(a)) will depend on its compliance with the qualifying criteria applicable to any other asset class.

43 Following the example provided in the preceding footnote, if the debt security concerned is denominated in a foreign currency (e.g. "currency B") which is not the local currency of jurisdiction A, the reporting institution can recognise the debt security as level 1 HQLA under sub-item A1(e) up to an amount not exceeding the total net cash outflows of the institution in currency B (arising from the banking business conducted by the institution in jurisdiction A).

44 As noted in paragraph 19, the relevant BCR provisions for risk-weighting purposes are section 55(2) (in the case of sovereigns or central banks) and section 57(2)(b) (in the case of public sector entities).

45 Pursuant to section 2(2) and section 3(2) of Part 2 of Schedule 2 to the BLR, category 1 institutions are allowed to report marketable debt securities that qualify for inclusion under both sub-item A1(d) (or A1(e)) and sub-item A2(a) as level 1 assets under sub-item A1(d) (or A1(e)). This is consistent with Footnote 17 of the 2013 BCBS LCR Document.

A2(b) Report in this sub-item the fair value of marketable debt securities that comply with the requirements set out in Schedule 2 (section 2(b) in Part 1 and section 5 in Part 2) of the BLR. In particular, these debt securities must be issued by corporates[46] and assigned with a credit quality grade of 1 under Part 4 (STC approach) of the BCR.

The credit quality grade of a corporate debt security (or a covered bond in the case of sub-item A2(c)) is determined by either one of the following approaches:

(i) if the debt security (or covered bond) has an ECAI issue specific rating, map the rating to Schedule 6 to the BCR for determining the credit quality grade[47]; or

(ii) if the debt security (or covered bond) does not have an ECAI issue specific rating and the reporting institution holding the debt security is approved by the MA to use the IRB approach under section 8 of the BCR (if the institution is incorporated in Hong Kong) or by the institution's home supervisor (if the institution is incorporated outside Hong Kong) to use the internal ratings-based approach that reflects the standards of the BCBS to calculate capital charge for credit risk, use the institution's internally rated probability of default for the debt security as a reference for determining the credit quality grade.

A2(c) Report the fair value of covered bonds[48] that comply with the requirements set out in Schedule 2 (section 2(c) in Part 1 and section 6 in Part 2) of the BLR. In particular, the covered bonds reported in this sub-item must qualify for a credit quality grade of 1 under Part 4 (STC approach) of the BCR by following the CIs provided for sub-item A2(b).

A3 Level 2B assets

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46 The term "corporate" is defined in the BLR as –

(a) a company; or

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

This definition is adapted from that under the BCR to tailor for liquidity requirements.

47 In brief, a corporate debt security or a covered bond having a credit quality grade of 1 means that the instrument has a long-term ECAI issue specific rating of AA- or better (or a short-term ECAI issue specific rating representing a comparable level of credit quality).

48 The term "covered bond" is defined in the BLR as a bond, issued by a financial institution or any of its associated entities –

(a) which is subject to relevant laws or regulations that are specially designed to protect the holder of the bond; and

(b) the proceeds from the issue of which must, in conformity with those relevant laws or regulations, be invested in assets which, during the whole period of the validity of the bond, are capable of covering claims attached to the bond and which, in the event of the failure of the issuer of the bond, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest.

A3(a) Report in this sub-item the fair value of marketable debt securities that comply with the requirements set out in Schedule 2 (section 3(a) in Part 1 and section 7 in Part 2) of the BLR. In particular, these debt securities must be issued by corporates with a credit quality grade of 2 or 3 under Part 4 (STC approach) of the BCR. The approach to determining the credit quality grade set out in sub-item A2(a) also applies to this sub-item.

A3(b) Report in this sub-item the fair value of any residential mortgage-backed securities (RMBS) that comply with the requirements set out in Schedule 2 (section 3(b) in Part 1 and sections 8 and 9 in Part 2) of the BLR. In particular, the RMBS reported in this sub-item must have been approved by the MA (under section 9 of Part 2 of Schedule 2 to the BLR) for the reporting institution to include those securities as level 2B assets.[49]

A5 Adjustments for 15% ceiling on level 2B assets and 40% ceiling on level 2A and level 2B assets

Complete Table 1 of Section (II) of this Part according to the CIs provided in **Annex 3**, including adjustments before and after the reversal by the reporting institution of any securities financing transaction[50] that the institution may have entered into involving an exchange with its counterparty, during the LCR period, of an HQLA qualifying asset[51] for another HQLA qualifying asset. Table 1 will generate the required figures for this item.

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49 As mentioned in L3 (paragraph 50), an AI must obtain the MA's approval for it to include any RMBS as HQLA under the LCR (or as "liquefiable assets" under the LMR as the case may be). The applying institution must demonstrate to the MA's satisfaction that the RMBS under application meet (i) those qualifying criteria specified by the BCBS in respect of RMBS (as set out under section 8 in Part 2 of Schedule 2 to the BLR); and (ii) the characteristics and operational requirements which are applicable to HQLA in general (as set out in Schedule 2 to Schedule 4 of the BLR). Upon receipt of an AI's application, the MA will assess critically (i) the compliance of the relevant RMBS with the applicable qualifying criteria and requirements; (ii) the AI's ability to manage the relevant risks of holding such RMBS, as reflected from its relevant risk management policies, procedures and exposure limits; and (iii) the AI's overall risk management capability as observed by the MA in the course of ongoing supervision. It is therefore necessary for the applying AI to conduct a detailed assessment of the relevant RMBS and provide the relevant information for the MA to consider its application.

To avoid doubt, an AI having included certain RMBS issues as liquefiable assets under the Liquidity Ratio must apply to the MA for inclusion of the same securities for LCR (or LMR) purposes.

50 The term "securities financing transaction" is defined in the BLR as, in relation to a category 1 institution, (a) a repo-style transaction; or (b) a margin lending transaction. The term "repo-style transaction" follows the meaning assigned to it in the BCR.

51 As defined in BLR, "HQLA qualifying asset" means an asset referred to in section 26(a) of the BLR. That is, this refers to an asset that falls within any class of level 1 assets, level 2A assets or level 2B assets specified in Schedule 2 (Part 1) to the BLR and meets the relevant qualifying criteria (if any) specified in Schedule 2 (Part 2) to the BLR for the relevant class of assets.

A6 Additional adjustment due to foreign exchange haircuts (if applicable)

Explanatory Note: If a category 1 institution has maintained a level of "HKD LCR mismatch" [52]*, the institution may, under ALA Option 2, use foreign currency-denominated HQLA (which must be level 1 assets) to cover the HKD LCR mismatch, subject to certain requirements set out in sections 37 to 39 of the BLR (supplemented by further elaboration in LM-1), including the application of foreign exchange haircuts on the relevant portion of foreign currency-denominated assets that are used to cover HKD LCR mismatch exceeding a certain threshold of usage (re section 39 of the BLR). Table 2 of Section (II) of this Part enables the additional adjustment due to foreign exchange haircuts to be automatically generated based on the currency-specific data reported by the institution in Table 2 of Section (I) of this Part. A numerical example is provided in* ***Annex 1*** *to demonstrate the calculation of the foreign exchange haircuts, which will be mapped to item A6 of Section (I) of this Part for deduction from the total HQLA of the relevant institution.*

B. Total expected cash outflows

B1,B2 Retail deposits

Retail deposits taken by Hong Kong office

Report in item B1 the book value (including accrued interest) of retail deposits taken by the reporting institution in its Hong Kong office. Interest to be accrued (and payable by the institution) within the LCR period should also be reported in this item. Provide a breakdown of these deposits by (i) stable retail deposits[53]; (ii) less stable

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[52] The term "HKD LCR mismatch" is defined in the BLR and as described in Footnote 27 of this Return.

The definition implies a baseline situation in which a category 1 institution has an amount of HKD-denominated HQLA that fully covers its HKD-denominated total net cash outflows. If, however, the institution needs to adopt ALA Option 2 (pursuant to sections 37 to 39 of the BLR), the HKD LCR mismatch position will be filled by foreign currency-denominated level 1 assets, either in whole (when the minimum LCR requirement is 100% starting from 2019) or in part (when the minimum LCR requirement is below 100% during the phase-in period from 2015 to 2018).

[53] Under the BLR, the term "stable retail deposit" refers to a deposit taken by a category 1 institution from a retail customer (who is a natural person) and that is payable on demand, or has a remaining term to maturity (or a withdrawal notice period) within the LCR period, where –

(a) the deposit is fully insured by an effective deposit insurance scheme; and

(b) either –

  (i) the retail customer has <u>at least 2 other established relationships</u> with the institution, in which –

    (A) subject to clause (B), at least one of the relationships (but not that of a credit card account) has been established for not less than <u>6 months</u> and the account underlying that relationship has not been dormant or inactive in the last 6 months; and

    (B) the requirement in clause (A) is deemed to be met if the relationship relates to a mortgage loan that charges a penalty for early settlement of the loan <u>within 6 months</u> from the date that the loan is drawn down;

  or

retail deposits[54]; and (iii) retail term deposits.[55] If the institution is not able to ascertain whether a retail deposit can meet the criteria for being classified as a "stable retail deposit", it must report that deposit as a "less stable retail deposit".

For the purposes of reporting the breakdown of a deposit item by currency, if a retail customer has placed deposits denominated in more than one currency with the reporting institution and these deposits are covered by an effective deposit insurance scheme[56] (EDIS), assume that the EDIS covers these deposits in the order of (i) HKD deposits; (ii) USD deposits; (iii) deposits denominated in other major currencies (i.e. EUR, JPY and GBP); (iv) RMB deposits; and (v) deposits denominated in other currencies. (This assumption is also applicable to items B3 to B6, where deposit insurance coverage is also a relevant factor affecting the calibration of these items.)

Retail deposits taken by overseas offices[57]

Item B2 is applicable to locally incorporated reporting institutions whose overseas offices (e.g. overseas branches or overseas specified associated entities) have taken retail deposits, for the purposes of reporting their LCR on an unconsolidated basis,

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(ii) the deposit is maintained by the retail customer in a transactional account at the institution.

The term "fully insured" under paragraph (a), in relation to a deposit covered under an effective deposit insurance scheme, means 100% of the deposit amount (up to the deposit coverage limit) is insured by the scheme.

The above definition is largely the same as that proposed in L3, except that the required number of "other established relationships" has been increased to two (from one as originally proposed in L3) and the minimum duration of such a relationship has been shortened to six months (from 12 months as originally proposed in L3), after considering industry comments on the original proposals in L3.

54 Under the BLR, the term "less stable retail deposit" means a retail deposit taken by a category 1 institution that is not a stable retail deposit or retail term deposit. The minimum outflow rate for such deposits is 10% (please refer to the reporting template for sub-item B1(b) under Section (I) of this Part). Although no additional buckets for such deposits with higher outflow rates are currently prescribed, it is the MA's intention to exercise his power under section 97K of the BO to increase the outflow rate of such deposits (in whole or in part) for individual institutions if the MA is satisfied that it is prudent to do so, taking into account the liquidity risks posed by such deposits to the institution concerned.

55 Under the BLR, the term "retail term deposit" means a deposit, taken by a category 1 institution from a retail customer, that has a remaining term to maturity, or a withdrawal notice period, greater than the LCR period, and in respect of which –

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

56 The EDIS is as defined in the BLR, and includes the Hong Kong Deposit Protection Scheme.

57 Paragraphs 168 to 170 of the 2013 BCBS LCR Document allow banks to calculate the expected cash outflow arising from retail deposits and small business funding obtained by their overseas banking operations in accordance with the liquidity regulations applicable to such deposits and funding set out by the relevant host supervisor of the jurisdiction(s) concerned. Where there are no liquidity regulations applicable to such deposits and funding in the host jurisdiction, or where the home requirements are stricter than the host requirements, the home supervisor may require banks to apply liquidity regulations applicable to such deposits and funding in the home jurisdiction. Such treatment is reflected in section 23 of the BLR.

consolidated basis and/or other basis specified by the MA under section 13 of the BLR (where applicable). Unless otherwise advised by the MA, the expected cash outflow arising from those overseas retail deposits is calculated in accordance with the liquidity regulations applicable to such deposits imposed by the relevant banking supervisory authority of the host jurisdiction[58] concerned in which the deposits are taken.

Report in item B2 the aggregate book value (including accrued interest) of retail deposits taken by all overseas offices of the locally incorporated reporting institution, including the aggregated expected cash outflows arising from retail deposits taken by each of those overseas offices. Any interest to be accrued (and payable by the institution) within the LCR period should also be reported in this item. This necessitates the institution to maintain internal systems that enable the calculation of such expected cash outflows in accordance with the respective liquidity regulations applicable to those deposits in the relevant host jurisdictions.

The following is an illustration of how item B2 should be reported assuming that the reporting institution takes stable retail deposits in two overseas jurisdictions:

	Principal amount of stable retail deposits taken by an institution's overseas offices	Outflow rates applicable in the relevant jurisdiction
Jurisdiction A	USD1000 (equiv. HK$7800)	3%
Jurisdiction B	EUR200 (equiv. HK$2000)	5%

Sub-item B2(a) should be reported as follows:

	Principal amount	Weight	Weighted amount	Breakdown of weighted amount by currencies				
				HKD	USD	Other major $	RMB	Other $
2 Retail deposits taken by overseas offices								
(a) stable retail deposits	9800		334		234 =7800*3%	100 =2000*5%		

B3, B4 Small business funding[59]

58 Under the BCR, the term "host jurisdiction" refers to a jurisdiction outside Hong Kong in which any of a category 1 institution's overseas branches operates or any of its associated entities is incorporated.

59 Under the BLR, the term "small business funding" is defined as unsecured wholesale funding provided to a category 1 institution by small business customers.

The term "small business customer" is defined in the BLR as a corporate (or, if applicable, a group of related corporates) which has provided a category 1 institution with total aggregated funding of less than 10 million Hong Kong dollars (or its equivalent in another currency), and in respect of which –

(a) if the institution has a credit exposure to the corporate (or group), the credit exposure meets the criteria for the IRB subclass of small business retail exposures under section 144 of the BCR; or

Report in items B3 and B4 the principal amount of small business funding obtained by the reporting institution in accordance with the CIs for items B1 and B2, as if such funding is akin to retail deposits.

B5 Operational deposits

Report in this item the book value (including accrued interest) of operational deposits received by the reporting institution from wholesale customers (other than small business customers), including both financial institutions and non-financial entities. Interest to be accrued on these deposits (and payable by the institution) within the LCR period should also be reported in this item.

The deposits reported in this item must meet the qualifying criteria in relation to operational deposits provided in the CoP[60]. In order to ensure compliance with the relevant criteria, the reporting institution must put in place appropriate systems and methodology to distinguish between operational deposits and non-operational deposits (the latter include excess operational deposits[61]). If the institution is not able to identify operational deposits effectively, it must not treat any deposit as operational deposit.[62]

If the deposits taken by the reporting institution from a customer consist of both operational deposits and non-operational deposits, assume that the portion of deposits

(b) if the institution has no credit exposure to the corporate (or group), that aggregated funding is managed by the institution as if it were a retail deposit.

The term "total aggregated funding" is defined in the BLR as the gross amount of funding (including any deposit or other form of funding) provided to a category 1 institution by a small business customer (or a group of related small business customers as if the group were a single customer).

60 The CoP (clause 8) contains provisions in relation to the determination of the amount of operational deposits. These provisions follow the requirements provided in paragraphs 93 to 104 of the 2013 BCBS LCR Document.

61 As defined in the BLR, the term "excess operational deposit" refers to the portion of the operational deposit of a category 1 institution placed by a wholesale customer (other than a small business customer) kept in the customer's operational deposit account that is in excess of the level of operational deposit necessary to be kept in the account to enable the institution to provide operational services to the customer to meet the customer's operational needs.

62 The systems and methodology adopted by a category 1 institution for identifying operational deposits should be sufficient to facilitate ongoing assessment of the eligibility of deposits reported as operational deposits. The assessment should be conducted in a sufficiently granular manner, taking into account relevant factors that may affect the risk of withdrawal of such deposits, particularly in times of stress. The relevant factors that may be considered in assessing the amount of operational deposits include, for example, a customer's business relationships with the institution, the extent to which the customer has relied on the institution's operational services, historical trend of deposit balance (taking into account, for example, the absolute level and volatility of deposit balance), level of concentration of operational deposits taken from a small number (or a particular type) of depositors, etc. The HKMA will develop some guiding principles (in LM-1) for category 1 institutions to establish their respective systems and methodologies for assessing operational deposits.

that qualifies as operational deposits will take precedence over the remaining deposits when determining the level of protection covered under an EDIS (where applicable).

For example, assume that the reporting institution has taken the following deposits from customers:

(Unit: HK$000 equivalent)	Customer A (non-FI)	Customer B (non-FI)	Customer C (non-FI)	Customer D (FI)
Operational deposits	700	500	150	400
Other deposits not regarded as operational deposits	300	250	350	200
Total	1,000	750	500	600

The deposits are insured under an EDIS up to HK$500,000 equivalent per a customer's total eligible deposits placed with the institution.

The reporting institution should report the above deposits in item B5 (and item B6) as follows:

(Unit: HKD'000 equivalent)

		Customer A	Customer B	Customer C	Customer D
5	Operational deposits				
(a)	fully insured by an effective deposit insurance scheme	500	500	150	400
(b)	not covered under sub-item B5(a)	200	0	0	0
6	Unsecured wholesale funding				
(a)	(other than operational deposits) provided by corporates, etc.				
	(i) amount entirely protected by EDIS	0	0	350	0
	(ii) not covered under sub-item 6(a)(i)	300	250	0	0
(b)	other than funding covered under item B3, B4 or B5 or sub-item B6(a)	0	0	0	200

Report in sub-item B5(c), as a memorandum item, excess operational deposits (excluded from sub-item B5(a) or B5(b))[63]. As demonstrated in the above example, this portion of deposits should be included in item B6.

B6 Unsecured wholesale funding (other than operational deposits)

[63] This memorandum item will enable the HKMA to monitor the amount of deposits in operational deposit accounts which are carved out by a category 1 institution from the category of "operational deposits". The HKMA will develop guidance on major factors that should be considered by category 1 institutions in determining the amount of operational deposits and non-operational deposits if they are placed in a single account.

Report the book value (including accrued interest) of unsecured whole funding (other than operational deposits) in this item according to the CIs below. Interest to be accrued on such funding (and payable by the institution) within the LCR period should also be included.

Sub-item B6(a) covers unsecured wholesale funding (other than operational deposits) provided by corporates (other than small business customers), sovereigns, the MA for the account of the Exchange Fund, central banks, multilateral development banks and public sector entities. Report the funding concerned in two separate components:

(i) report in paragraph (i) the funding provided by customers captured in this sub-item the entire amount of which is fully insured by an EDIS; and

(ii) report in paragraph (ii) the funding provided by customers captured in this sub-item the entire amount of which is not fully insured by an EDIS.

Hence, if a customer provides funding of $800,000 to the reporting institution but the EDIS concerned provides full protection only up to $500,000 of a customer's eligible deposits, the $800,000 deposit does not fall within paragraph (i) and has to be reported in paragraph (ii) of this sub-item.

Report in sub-item B6(b) unsecured wholesale funding other than funding covered under item B3, B4 or B5 or sub-item B6(a). That means this sub-item does not include small business funding, operational deposits, and unsecured wholesale funding provided by wholesale customers (excluding small business customers) covered in sub-item B6(a). The customers covered in this sub-item include, for example, financial institutions[64], fiduciaries[65], beneficiaries[66], conduits and SPEs engaged in structured financing transactions[67], and any of the reporting institution's associated entities which is not a financial institution. Unsecured wholesale funding received by the institution in the course of providing correspondent banking and prime brokerage services should also be reported in this sub-item.[68] In addition, this sub-item should

[64] The term "financial institution" is as defined by section 157A(3) of the BCR.

[65] The term "fiduciary" means a legal entity that is authorized to manage assets on behalf of a third party. Fiduciary includes asset management entities such as pension funds and other collective investment vehicles. (Please refer to Footnote 43 of the 2013 BCBS LCR Document.)

[66] The term "beneficiary" means a legal entity that receives, or may become eligible to receive, benefits under a will, insurance policy, retirement plan, annuity trust or other contract. (Please refer to Footnote 44 of the 2013 BCBS LCR Document.)

[67] The term "structured financing transaction" is defined in the BLR as a collateralized transaction involving the issue of a structured financial instrument in which the repayment of obligations and other exposures to the transaction is largely derived, directly or indirectly, from the cash flows generated by the pool of underlying assets that secures the obligations and other exposures to the transaction.

[68] Ref: 2013 BCBS LCR Document, paragraph 111

include unsecured wholesale funding (other than small business funding) received by the reporting institution (or its specified associated entity) which is a DTC that is not subject to section 12(3) of the BO by virtue of the MA's written permission to early repay the funding concerned (see **Annex 4** for details).

B7 Debt securities and prescribed instruments issued by the reporting institution and redeemable within the LCR period

Report in this item the book value (i.e. the amount that is contractually redeemable upon maturity, including accrued interest) of debt securities and prescribed instruments issued by the reporting institution which are redeemable within the LCR period, irrespective of the type of investors holding these securities and instruments[69]. Interest to be accrued on these securities and instruments (and payable by the institution) within the LCR period should also be reported in this item.

To avoid doubt, this item does not cover the redemption of asset-backed securities, covered bonds or other structured financial instruments issued by the reporting institution within the LCR period. The expected cash outflow arising from the redemption of such instruments should be reported in item B17.

69 Although the 2013 BCBS LCR Document (paragraph 110) allows retail funding received by banks through issuance of "retail debt securities" can be treated in the same way as retail deposits subject to certain conditions, the HKMA considers it unlikely that any debt security or prescribed instrument (at least for the local markets) will be able to comply fully with the relevant conditions. Moreover, the implementation of this provision would mean that a category 1 institution must conduct ongoing verification of the identity of the investors holding the "retail bonds" issued by the institution in order to ensure compliance with the relevant criteria set out in paragraph 110 of the LCR text. The HKMA considers it not justifiable to implement this provision in Hong Kong, taking into account the operational burden that may be imposed on category 1 institutions.

B8 Secured funding transactions[70] (other than securities swap transactions[71])

Report in this item the book value (including accrued interest, if any) of money payable by the reporting institution within the LCR period arising from maturing secured funding transactions (which are not securities swap transactions). Breakdown the money payable by type of counterparty and/or type of collateral received from the counterparty as required. The specific currency columns should be reported based on the currency denomination of the money payable by the institution (irrespective of the currency denomination of the underlying collateral).[72]

If the reporting institution enters into a securities lending transaction under which the institution lends securities to the counterparty to cover its short positions in equivalent securities and receives a sum of money from the counterparty in exchange as collateral, the expected cash outflow arising from the transaction should be included under this item. If, however, the securities lent by the institution to the counterparty are obtained from another counterparty as collateral, and the securities do not qualify as HQLA, the expected cash outflow arising from the transaction should instead be included under item B21 as "other contingent funding obligations" (please refer to the CIs for item B21 for details).

For the purposes of reporting under sub-item B8(b), the term "qualifying public sector entity" means a public sector entity that qualifies for a risk-weight of not exceeding 20% in the calculation of credit risk under the STC approach (in accordance with section 57 of the BCR).

B9 Securities swap transactions

If the reporting institution has entered into a securities swap transaction that is due for settlement within the LCR period, complete Table 3 in Section (II) of this Part, which will generate the required figures for this item.

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70 Under the BLR, the term "secured funding transaction" means a securities repurchase transaction or securities lending transaction, or other similar transaction, entered into by a category 1 institution with a counterparty that provides a sum of money or other securities to the institution on a collateralized basis.

71 Under the BLR, the term "securities swap transaction" means (a) a securities lending transaction whereby a category 1 institution lends securities to a counterparty and receives other securities from the counterparty in exchange as collateral; or (b) a securities borrowing transaction whereby the institution borrows securities from a counterparty and provides other securities to the counterparty in exchange as collateral.

72 For example, if the reporting institution is obliged to pay an amount of money in Hong Kong dollars within the LCR period under a secured funding transaction which is collateralized by a security denominated in USD dollars, the institution should report the amount payable in the "HKD" column instead of the "USD" column.

In Table 3, report, in the appropriate rows, the principal amounts (measured at fair value) of securities to be delivered by the reporting institution within the LCR period under the maturing securities swap transactions it has entered into. In order to determine the row under which a particular securities swap transaction should be reported, the institution should ascertain the type of securities to be delivered by it and the type of securities to be received from the counterparty within the LCR period.

For example, a category 1 institution (Bank A) has incurred some positions arising from securities swap transactions conducted with its counterparty (Bank B). These transactions, as described below, are due for settlement within the LCR period.

Transaction (I): To deliver a level 1 asset (HKD1000) and to receive a level 2A asset;

Transaction (II): To deliver a level 2A asset ((USD100, which is assumed to be equivalent to HK$780) and to receive an RMBS that has not been approved by the MA for recognition by the institution as a level 2B asset.

Bank A should report its obligations to deliver securities under Transaction (I) and Transaction (II) in item (a) and item (g) of Table 3 respectively. It should complete this Table as follows, so as to generate the required data under item (k) for the purposes of item B9.

(Unit: HKD'000 equivalent)

	Type of securities to be delivered by reporting institution to counterparty within LCR period	Type of securities to be received by reporting institution from counterparty within LCR period	Principal amount of securities to be delivered by reporting institution	Weight	Weighted amount	Breakdown of weighted amount by currencies				
						HKD	USD	Other major $	RMB	Other $
(a)	level 1 assets	level 2A assets	1000	15%	150	150	0	0	0	0
(g)	level 2A assets	assets that are not level 1 assets, level 2A assets or level 2B assets	780	85%	663	0	663	0	0	0
(k)		Total	1780		813	150	663	0	0	0

(<u>Note:</u> If Bank B is also a category 1 institution, it should report the expected cash inflow arising from the two securities swap transactions (i.e. Transaction (I) and Transaction (II)) in item C3 of Section (I) by completing Table 4 in Section (II).)

If the reporting institution (or its counterparty) is contractually allowed to select securities from a list of allowable types of securities (with different levels of quality ad liquidity value) for delivery to each other in a securities swap transaction, and the institution (or its counterparty) has not confirmed what type of securities the institution (or its counterparty) will deliver under the transaction, the institution may assume that it (or its counterparty) will select from the list the type of securities to be delivered in the following order:

1st:	assets that do not qualify as HQLA;
2nd:	level 2B assets that are not approved RMBS;
3rd:	approved RMBS;
4th:	level 2A assets; and
5th:	level 1 assets.

B10 Derivative contracts

Complete Table 5 of Section (II) of this Part following the CIs provided in **<u>Annex 5</u>**, if the reporting institution has any liabilities or obligations arising from derivative contracts within the LCR period. This Table will generate the required figures for cash outflow item B10 (and also cash inflow item C9) under Section (I) of this Part.

B11 Derivative contracts or other transactions with material adverse event clauses[73]

If the reporting institution has entered into any derivative contract or other transaction which contains a material adverse event clause requiring the institution to pay a sum of money or deliver additional collateral to the counterparty in case the event occurs, report the contracted amount of the sum of money to be paid or the fair value of the collateral to be delivered (or both, as the case may be) by the institution within the LCR period, [if there is a reasonable expectation that the material adverse event will occur within the LCR period] [74].

B12 Potential loss in market value of posted collateral securing derivative contracts or other transactions

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73 As defined in the BLR, the term "material adverse event" means, in relation to a derivative contract or other transaction entered into by a category 1 institution with a counterparty, an event specified in the contract that relates to adverse changes in the institution's credit-worthiness or financial conditions (including a 3-notch downgrade in its ECAI issuer rating or a downgrade of such rating to a non-investment grade), the occurrence of which will require the institution to fulfil its obligations specified in the contract (which may include the payment of a sum of money or the posting of additional collateral) to the counterparty.

74 For example, if a category 1 institution's ECAI rating has been downgraded by three notches or to a level below BBB- (or if there is a reasonable expectation that this event will happen) and this event will result in any contractual obligation for the institution to pay a sum of money or deliver additional collateral to the counterparty within the LCR period, the expected cash outflow arising from this situation should be reported in item B11.

Complete Table 6 of Section (II) of this Part following the CIs provided in **Annex 6**, if the reporting institution has posted any asset to the counterparty as collateral under a derivative contract or other transaction[75] . Table 6 will generate the required figures for this item.

B13 Excess non-segregated collateral callable by counterparty under derivative contracts or other transactions[76]

Report in this item the fair value of collateral posted to the reporting institution by a counterparty in excess of the contractually required amount if the counterparty has a unilateral right to withdraw the excess collateral on demand or within the LCR period, and the collateral received by the institution is not segregated from other assets held by the institution, meaning that the excess collateral, may be or has already been, re-hypothecated by the institution, counted as the institution's HQLA if the collateral is so qualified, or utilized by the institution for its other business operations.

B14 Potential substitution of non-segregated HQLA collateral posted by counterparty by HQLA collateral at a lower level or non-HQLA collateral under derivative contracts or other transactions

This item captures situations in which the reporting institution has received HQLA collateral from the institution's counterparty under a derivative contract or other transaction, whereby the collateral is not segregated from other assets held by the institution and the counterparty has a contractual right to substitute the HQLA collateral posted to the institution by HQLA collateral of lower liquidity quality or non-HQLA collateral anytime within the LCR period. It is assumed that the counterparty will exercise the right within the LCR period by substituting the HQLA collateral by collateral of the lowest liquidity quality among the allowable types of

75 This item is applicable to derivative contracts or other transactions, as long as the posted collateral is subject to market risk thus rendering a category 1 institution potentially obliged to post additional collateral to its counterparty if the collateral drops in value. For example, in a repo transaction, an institution's expected repayment of secured funding within the LCR period is included in item B8. If the institution has a contractual obligation under the transaction to top up the collateral in case the collateral value decreases, it should also account for the additional liquidity risk associated with this contractual obligation under item B12, if this liquidity risk has not been captured elsewhere.

76 The rationale for this item is that, if a category 1 institution has not segregated the counterparty's excess collateral from the institution's own assets (implying that the excess collateral is able to be, or may have already been, used by the institution to secure other funding transactions), the counterparty's call on the excess collateral will likely weaken the institution's liquidity position as measured under the LCR on a dollar-to-dollar basis. An outflow rate of 100% is therefore required for the excess collateral (if the institution has the right to re-hypothecate, or has already re-hypothecated, the excess collateral to obtain liquidity).

assets to be substituted.[77] Complete Table 7 under Section (II) of this Part, which will generate the required figures for this item.

In Table 7, report, in the appropriate rows, the principal amounts (measured at fair value in the case of marketable assets) of collateral posted to the reporting institution by the counterparties under the derivative contracts or transactions concerned. In determining the row under which each of those contracts or transactions should be reported, the institution should ascertain –

(i) the type of HQLA collateral posted by the counterparty to the institution (Column 2 of Table 7); and

(ii) the type of assets that may be posted by the counterparty to the institution for collateral substitution (Column 3 of Table 7).

The type of assets under (ii) is derived by applying the following order of collateral substitution (to the extent allowed under the relevant contract or transaction):

1st: assets that do not qualify as HQLA;
2nd: level 2B assets that are not approved RMBS;
3rd: approved RMBS;
4th: level 2A assets; and
5th: level 1 assets.

As an illustration, if the counterparty is contractually allowed to substitute HQLA collateral which consists of level 1 assets by collateral that falls with level 2A assets and level 2B assets and any other asset (i.e. non-HQLA), it is always assumed that the counterparty will use non-HQLA for collateral substitution. In other words, the contract or transaction should be reported under item (d) of Table 7 with an applicable outflow rate of 100%. If, however, the type of collateral allowed to be substituted is confined to HQLA (i.e. level 1, level 2A and level 2B assets), it is assumed that the counterparty will always use level 2B assets that are not "approved RMBS" for collateral substitution. In other words, the contract or transaction should be reported under item (c) of Table 7 with an applicable outflow rate of 50%.

B15 Contractual obligations to post collateral to counterparty under derivative contracts or other transactions (not otherwise covered in Section (I)B)

If the reporting institution has any contractual obligation to provide collateral to its counterparty under a derivative contract or other transaction within the LCR period,

[77] Ref: BCBS LCR FAQ (April 2014), no. 9 (f) to (h)

report in this item the principal amount of collateral (measured at fair value in the case of marketable assets) that the institution is required to provide to the counterparty, unless this obligation is already captured under other cash outflow items in Section (I) of this Part. This contractual obligation should be reported irrespective of whether the counterparty has actually demanded the institution to provide additional collateral.

B16 Increased collateral needs arising from adverse changes in market value of derivative contracts or other transactions (re historical volatility in value of such contracts or transactions – Value X)

If the reporting institution has entered into derivative contracts or other transactions that are subject to collateral requirements, report in this item the estimated amount of additional collateral that has to be posted to counterparties arising from adverse changes in the market value of such contracts or transactions ("Value X") by applying the formula and steps listed below.

Value X is <u>the largest absolute value of the total cumulative amount of net collateral flow of a category 1 institution realized in any period of 30 calendar days during the 24 months preceding to the date on which the reporting institution's LCR is calculated</u>. It should be calculated according to the following formula:

$$\text{Value X} = \text{Max}\{|\textstyle\sum_{n=1}^{30}(\text{daily net collateral flow})_n|,\ |\sum_{n=2}^{31}(\text{daily net collateral flow})_n|, \dots$$
$$\dots, |\textstyle\sum_{n=701}^{730}(\text{daily net collateral flow})_n|\};$$

where –

(a) **(daily net collateral flow)$_n$** means net amount of collateral inflows or outflows on day "n" caused by changes in the fair value of derivative contracts or other transactions subject to collateral requirements; and

(b) it is assumed that 24 months consist of 730 calendar days.

If the reporting institution is not able to calculate Value X due to data insufficiency or any other reason, the institution should notify the MA of this inability and the reasons for it, and agree an alternative calculation method with the MA for reporting under this item.

For the purposes of reporting the breakdown of Value X by currency, adopt the approximation method illustrated in the example below.

Assume the reporting institution's Value X (on an all-currency basis) is HK$100 and that its total liabilities (including shareholders' funds) at the end of the most recent financial disclosure period had a currency profile as follows:

	Total	HKD	USD	Other major $	RMB	Other $
Total liabilities (including shareholders' funds)	100%	60%	15%	10%	5%	10%

Approximate the currency breakdown of Value X as follows:

	Total	HKD	USD	Other major $	RMB	Other $
Value X	100	60 (100*60%)	15 (100*15%	10 (100*10%	5 (100*5%)	10 (100*10%)

B17 Repayment of funding obtained from structured financial instrument issued by the reporting institution and redeemable within the LCR period

If the reporting institution has issued any asset-backed securities, covered bonds or other structured financial instruments which will mature within the LCR period, report in this item the book value (including accrued interest) of these financial instruments to be redeemed. Interest to be accrued on these instruments (and payable by the institution) within the LCR period should also be reported in this item.

If the redemption of the above-mentioned securities or instruments will entitle the institution to receiving HQLA qualifying assets within the LCR period, the fair value of these assets (after applying the post-haircut factors specified in section 36(1) of the BLR in the case of level 2A or level 2B assets) can be deducted from, and only up to, the amount to be reported under this item.

B18 Obligations to provide assets or funding in respect of structured financing transactions[78]

If the reporting institution has entered into structured financing transactions with the obligations to repay any debt maturing within the LCR period under those transactions, and/or provide any assets or funding that may arise from any embedded options in those transactions within the LCR period, report in this item –

[78] This item captures expected cash outflows associated with loss of funding on structured financing transactions including asset-backed commercial paper, conduits, securities investment vehicles and other such financing activities which may result from (i) the inability to refinance maturing debt, (ii) the existence of derivatives or derivative-like components contractually written into the documentation associated with structured financing transactions that would allow the "return" of assets in a financing arrangement, or that require the original asset transferor to provide liquidity, effectively ending the financing arrangement ("liquidity puts") within the LCR period or (iii) any other obligations.

(i) the book value (including accrued interest) of such maturing debt (if not already included under item B17) and also any interest to be accrued on the maturing debt (if the payment of such interest will rely on the funding to be provided by the institution); and

(ii) the assets or funding (measured at fair value in the case of marketable assets, or otherwise measured at book value according to the CI provided in paragraph (i) above) that may need to be provided by the institution under the embedded options in the transactions.

If the reporting institution conducts a structured financing transaction via a special purpose entity [79] (which may be a special purpose vehicle, conduit or structured investment vehicle), the institution should, for the purposes of this item, treat the entity as if it were a part of the institution irrespective of whether the entity is a specified associated entity of the institution. In other words, the institution should, in reporting this item, look through to the maturity of the debt instruments issued by the entity, and any embedded options in those instruments that may potentially trigger the need to provide assets or funding, as if those debt instruments were issued by the institution itself.

B19 Estimated drawdown of undrawn committed facilities

Report, in Table 8 of Section (II) of this Part, the undrawn portion of committed credit facilities and committed liquidity facilities[80] that can potentially be drawn by customers

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[79] As defined in the BLR, the term "special purpose entity" means a company, trust or other entity —

(a) created for a specific purpose;
(b) the activities of which are limited to those appropriate to achieving that purpose;
(c) the structure of which is intended to isolate the entity from the credit risk of an originator or seller of exposures; and
(d) that is commonly used as a financing vehicle in which exposures are sold to a company, trust or similar entity in exchange for a sum of money or other assets funded by debt issued by the company, trust or similar entity, as the case may be.

[80] The BLR defines –

(i) the term "committed facility" as a contractual agreement between a category 1 institution and its customer whereby the institution has a contractually irrevocable commitment to extend funds to the customer at a future date, whether for credit or liquidity purposes, in accordance with the terms and conditions specified in the agreement; and

(ii) the term "committed liquidity facility" as a committed facility that serves as a standby facility granted by a category 1 institution to its customer to refinance the customer's debt obligations (for example, pursuant to a commercial paper programme) in situations where the customer is unable to refinance those debt obligations in financial markets.

In addition, pursuant to Clause 22(4) and (5) of the CoP, for the purposes of this item –

(i) subject to paragraph (ii), a committed facility is treated as a committed credit facility if the facility is granted by a category 1 institution to a corporate for the purposes of financing the corporate's general working capital or import or export activities; and of the reporting institution within the LCR period. Table 8 will generate the required figures for this item.

If the reporting institution has received (or will receive upon drawdown) collateral that qualifies as HQLA to pledge against a committed facility granted by the institution to a customer, the post-haircut fair value (i.e. after applying the post-haircut factors set out in section 36(1) of the BLR) of the HQLA collateral may be deducted from the undrawn portion of that facility if –

(i) the institution is legally entitled and operationally capable of re-hypothecating the pledged asset to obtain funding once the facility is drawn, but it has yet done so;

(ii) the institution has no obligation to return the collateral to the customer or to any third party upon demand or at any time within the LCR period;

(iii) the collateral is not included by the institution as HQLA for the purposes of calculating the LCR[81]; and

(iv) there is no undue correlation between the probability of drawing on the facility and any potential decline in the fair value of the collateral. In other words, the drawdown of the facility is not expected to have material impact on the fair value of the asset.

For the purposes of reporting the currency breakdown in this item –

(i) if the HQLA collateral mentioned above is denominated in a currency that is not the same as that of the committed facility, convert the post-haircut fair value of the collateral into the currency in which the committed facility is denominated before deduction from the undrawn portion of the facility; and

(ii) if a committed facility is a multi-currency facility and the institution cannot ascertain the currency denomination of the amount of the facility that may be drawn by the customer within the LCR period, report the currency breakdown of the drawn amount as if the facility would be drawn in Hong Kong dollars. (If the multi-currency facility does not allow drawdown in Hong Kong dollars,

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(ii) a committed facility granted by a category 1 institution to a hedge fund, money market fund or special purpose entity (including any special purpose funding vehicle) is treated as if the facility were entirely a committed liquidity facility, which should be captured by sub-item 2(f) of Table 8 in Section (II) of this Part.

81 This requirement is to avoid double counting of the HQLA collateral in the calculation of the LCR.

assume the facility will be drawn by order of: US dollars, other major currencies, RMB and lastly other currencies (where applicable).)

If the reporting institution has granted a committed facility to its customer in order to provide standby liquidity support for the customer's debt obligations, report in this item the undrawn portion of the facility as a committed liquidity facility only to the extent of the customer's debt obligations that will mature within the LCR period and is supported by the facility. There is no need to include that portion of the facility which is backing the customer's debt obligations that will mature beyond the LCR period. However, if the facility can be drawn for other purposes (i.e. not being confined to the provision of standby liquidity support for the customer's debt obligations), the undrawn amount of the facility in excess of the customer's debt obligations maturing within the LCR period (representing additional capacity of the facility to support other purposes within the LCR period) should be reported as if it were a committed credit facility.[82]

If the reporting institution has entered into a structured financing transaction and provided a committed liquidity facility to support that transaction, it is not necessary for the institution to include the committed liquidity facility for the purposes of this item, provided that the institution has included the structured financing transaction in the reporting of expected cash outflow under item B17 or B18 (or both), as the case may be.

B20 Contractual [lending] obligations not otherwise covered in Section (I)B

Report, in Table 9 of Section (II) of this Part, the contracted amount of the following contractual [lending] obligations not otherwise covered in Section (I)B of this Part:

(i) contractual [lending] obligations to financial institutions, the MA for the account of the Exchange Fund, or central banks; and

(ii) contractual [lending] obligations to –

(a) retail customers;
(b) small business customers; and

[82] For example, Bank A has granted a committed facility with a usable limit of $10 million to provide standby liquidity support for a customer's debt obligations. If the customer's debt obligations covered by this facility consists of $1 million maturing within the LCR period and $2 million maturing beyond the LCR period, Bank A should report in item B19 an undrawn amount of $1 million as a committed liquidity facility. If this facility is granted for the mentioned purpose only, Bank A does not have to report any undrawn amount as a committed credit facility. However, if this facility can be used by the customer for other purposes, Bank A should report the remaining usable portion of this facility (i.e. $10 million - $1 million = $9 million) as a committed credit facility if this remaining portion can be drawn by the customer for purposes other than debt coverage within the LCR period.

(c) sovereigns, public sector entities, multilateral development banks, wholesale customers (excluding small business customers) or any other persons not included in paragraph (i) and paragraph (ii)(a) and (b).

Table 9 will generate the required figures for this item.

B21 Other contingent funding obligations[83]

Report the reporting institution's other contingent funding obligations, as specified in Table 10 of Section (II) of this Part, which will generate the required figures for this item.

In Table 10 –

(i) Report in item 1 the total contracted amount of trade-related contingencies[84] that are related to import or export trade transactions conducted by the reporting institution's customers. This item does not capture undrawn commitments under trade financing facilities (which should be captured in item B19 of Section (I) as calculated in Table 8 under Section (II) of this Part).

(ii) Report in item 2 the total contracted amount of guarantees and letters of credit provided by the reporting institution that are not stemmed from import or export trade transactions of its customers.[85]

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83 As defined in the BLR, the term "other contingent funding obligation" means a contractual or non-contractual contingent funding obligation of the institution that is not (a) a lending commitment; and (b) otherwise included in the calculation of total net cash outflows under the LCR.

84 As defined in the BCR, the term "trade-related contingency" —
(a) means a contingent liability which relates to trade-related obligations; and
(b) includes liabilities arising from issuing and confirming letters of credit, acceptances on trade bills, and shipping guarantees.

85 For example,

(1) A category 1 institution has granted a trade-financing facility with a credit limit of $100 million to a customer. If the institution has issued an L/C of $20 million to facilitate an import trade conducted by the customer and the institution's obligation under the L/C may be called upon within the LCR period, the institution should report its contingent obligation under this L/C in item 1 of Table 10 under Section (II). The remaining usable credit limit under the trade-financing facility ($80 million) should be reported in Table 8 under Section (II).

(2) If the institution has also issued a letter of guarantee with a guaranteed amount of $10 million to support the customer's business activity which is not directly related to a specific trade transaction, the institution should report that guaranteed amount ($10 million) in item 2 of Table 10 under Section (II) if its contingent obligation under the guarantee may be called upon within the LCR period. The remaining usable credit limit under the facility reported in Table 8 under Section (II) will then be $70 million.

(3) If the institution's contingent obligation under the L/C or the guarantee has been called upon and the payment date has been confirmed to fall within the LCR period, the amount payable by the institution should be reported in Table 9 under Section (II) (so that the expected cash outflow will be reflected in item B22 of Section (I)).

(iii) Report in item 3 the total contracted amount of the undrawn portion of uncommitted facilities granted by the reporting institution. An uncommitted facility means a credit facility or liquidity facility which is unconditionally cancellable by the institution without prior notice to the borrower.

(iv) Report in item 4 non-contractual contingent funding obligations [86] of the reporting institution, as specified in sub-items (a) to (e).

(a) Sub-item 4(a) caters for situations in which the reporting institution may have the non-contractual contingent funding obligation to repurchase (or early redeem) debt securities or structured financial instruments, irrespective of whether the maturity of which is beyond the LCR period, by virtue of the institution's (or its associated entity's) association with such debt securities (as the issuer, market maker or dealer) or such financial instruments (as the originator, sponsor, marketing agent or seller), especially in times of stress[87]. Report in this sub-item the book value (including accrued interest) of such debt securities or financial instruments if the institution is satisfied[88] that there is a reasonable expectation that the non-contractual contingent funding obligation will be materialized within the LCR period. If the

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(4) If the institution has received from the customer any HQLA collateral to cover the facility mentioned in paragraph (1) of this footnote, the institution may deduct the collateral value (after applying the haircut applicable to level 2A assets and level 2B assets as the case may require) for the purposes of reporting the expected cash outflows mentioned in paragraphs (1), (2) and (3). In reporting these expected cash flows, the institution may assume that the collateral received is deployed to cover the cash outflow items in a descending order of the outflow rates applicable to those items.

(5) If the institution will receive money from the customer within the LCR period to cover the amount payable as mentioned in paragraph (3), the institution may report the amount receivable as a cash inflow in item C10 of Section (I). If the institution converts the amount payable into a loan to the customer and the loan will mature within the LCR period, the loan can be reported as a cash inflow in item C4 of Section (I).

86 Under the BLR, the term "non-contractual contingent funding obligation" includes, but is not limited to, an obligation of a category 1 institution that is –

(a) associated with the issue or sponsorship of financial instruments (including structured financial instruments), or the provision of financial services that may necessitate the funding support of, or the extension of funds by, the institution in times of financial stress; or

(b) embedded in financial instruments (including structured financial instruments) originated, sponsored, marketed or sold by the institution that may render it necessary for the institution, out of reputation risk considerations, to repurchase those instruments from the holders of the instruments if there is a failure to satisfy the holders' reasonable expectations about the liquidity and marketability of the instruments.

87 For example, the reporting institution which has sponsored the issue of a structured financial instrument by its associated entity may be obliged to repurchase the financial instrument when its associated entity is in financial trouble.

88 Wherever the phrase "the institution is satisfied" is referred to in this Part for the purposes of reporting any particular item, the HKMA expects the institution concerned to exercise due diligence to ascertain that there are reasonable grounds supporting the reporting of the item concerned.

institution expects that this obligation also covers the interest to be accrued on such securities or instruments within the LCR period, the interest payable by the institution should also be reported in this item.

(b) Sub-item 4(b) caters for situations in which the reporting institution may have the non-contractual contingent funding obligation to repurchase money market funds or other collective investment funds marketed by the reporting institution (or its associated entity) owing to, for example, failure to satisfy reasonable expectations from investors about the liquidity and marketability of the funds concerned.[89] Report in this sub-item the fair value of the funds if the institution is satisfied that there is a reasonable expectation that the non-contractual contingent funding obligations will be materialized within the LCR period.

(c) Sub-item 4(c) caters for situations in which customer short positions[90] of the reporting institution are covered by non-HQLA collateral received from the institution's other customers in respect of which the institution has the right of re-hypothecation such that the institution may be obligated to provide funding to cover uncovered customer short positions in the event of withdrawal of the non-HQLA collateral by its other customers. Report in this sub-item the fair value of such non-HQLA collateral that is used to cover customer short positions.[91]

(d) Sub-item 4(d) caters for situations in which the reporting institution may have the non-contractual contingent funding obligation to meet potential liquidity draws by a joint venture of the institution or its minority investment in an entity which is not consolidated for the purposes of section 12(1) of the BLR, where there is a reasonable expectation that the institution will be the main liquidity provider when the joint venture or entity concerned is in need of liquidity. If the institution's obligation to provide liquidity to the joint venture or minority investment entity has been captured in any other cash outflow item, there is no need to include the obligation in this sub-

89 For example, the investment funds may be marketed with the objective of maintaining a stable value or the investors may anticipate ready marketability of those funds.

90 Under the CoP, the term "customer short position" refers to a short position created by a customer of a category 1 institution when the customer sells a security he does not own, which is subsequently covered when the institution delivers to the customer, under a securities lending transaction, an equivalent security, acquired from internal or external sources, on the settlement date of the sale.

91 If the asset is an HQLA qualifying asset, the transaction can be included in item B8 of Section (I) of this Part, where the expected cash outflow of the transaction is calculated based on a lower outflow rate.

item[92]. Before reporting any non-contractual contingent funding obligation under this sub-item, the institution should notify the MA the existence of the obligation and the circumstances giving rise to the obligation and agree with the MA the methodology for determining the amount of the obligation for the purposes of the LCR on a case by case basis.

(e) Sub-item 4(e) caters for any other non-contractual contingent funding obligations where the reporting institution is satisfied that there is a reasonable expectation that the obligations will be materialized within the LCR period. Report in this sub-item the amount of such obligations as expected by the institution.

B22 Other contractual cash outflows

Report in this item other contractual cash outflows of the reporting institution (not being contractual cash outflows relating to the operating expenses of the institution) that may occur within the LCR period and are not covered in the other cash outflow items in Section (I)B of this Part. These include, for example, expected cash outflows arising from uncollateralized securities borrowing transactions, uncovered short positions, amounts payable for transactions awaiting settlement, dividends and interest payable by the institution within the LCR period[93].

For uncollateralized securities borrowing transactions, uncovered short positions and similar transactions which do not have a definite term to maturity, assume that the transactions will be closed out and the reporting institution's liabilities or payment obligations arising from the transactions will be fulfilled within the LCR period. In the case of forward contracts, follow the CIs provided in **Annex 2**.

In addition, this item should include retail deposits and small business funding taken by the reporting institution (or its specified associated entity) which is a DTC that are not subject to section 12(3) of the BO by virtue of the MA's written permission to early repay the deposits or funding concerned (see **Annex 4** for details).

C. TOTAL EXPECTED CASH INFLOWS

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92 For example, the institution's contractual funding obligation arising from a committed facility granted to a joint venture or minority interest entity should be captured in item B19 instead of in this sub-item.

93 To avoid doubt, a long-term liability may render a category 1 institution liable to pay interest within the LCR period. Such interest payable should be included in the calculation of the institution's LCR even although the long-term liability may not be included.

C1,C2 Secured lending transactions[94]

Report in item C1 the principal amount of money (or the fair value of securities) to be received by the reporting institution within the LCR period arising from maturing secured lending transactions (including securities swap transactions), under which the institution has re-hypothecated securities obtained from the counterparty as collateral to cover the institution's short positions in equivalent securities, irrespective of the length of time the institution may carry its short positions[95].

Report in item C2 the principal amount of money (measured at book value, including accrued interest) to be received by the institution from maturing secured lending transactions (other than securities swap transactions) not included in item C1 within the LCR period by the type of underlying collateral.

Report in the specific currency columns for items C1 and C2 the principal amounts based on the currency denomination of the money (or the currency denomination of the securities in case of securities swap transactions included in item C1) to be received by the institution. In other words, it is not necessary for the institution to consider the currency denomination of the underlying collateral obtained from (hence to be returned to) the counterparty.[96]

C3 Securities swap transactions not covered in item C1

If the reporting institution has any securities swap transactions (which are not covered in item C1 and are due for settlement within the LCR period), complete Table 4 in Section (II) of this Part, which will generate the required figures for item C3.

In Table 4, report, in the appropriate rows, the principal amounts (measured at fair value) of securities to be received by the reporting institution within the LCR period under the maturing securities swap transactions it has entered into. In order to determine the row under which a particular securities swap transaction should be

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94 For LCR purposes, the term "secured lending transaction" is defined in the BLR as a securities reverse repurchase transaction or securities borrowing transaction, margin lending transaction, or other similar transaction, entered into by a category 1 institution with a counterparty in which the institution provides a sum of money or other securities to the counterparty on a collateralized basis. The term "secured lending" is defined as a category 1 institution's exposure to the counterparty under the transaction which is collateralized by the institution's legal right to a designated asset (or a designated pool of assets) owned by the counterparty in the case of the default, bankruptcy, insolvency, liquidation or resolution of the counterparty.

95 Ref: BCBS LCR FAQ (April 2014), no. 18

96 For example, if the reporting institution will receive a sum of money in Hong Kong dollars upon the maturity within the LCR period of a secured lending transaction which is collateralized by a security denominated in USD dollars, the institution should report the money receivable in the "HKD" column instead of the "USD" column.

reported, the institution should ascertain the type of securities to be received by it and the type of securities to be delivered by the counterparty within the LCR period.

If the reporting institution (or its counterparty) is contractually allowed to select securities from a list of allowable types of securities (with different levels of quality and liquidity value) for delivery to each other in a securities swap transaction, and the institution (or its counterparty) has not confirmed what type of securities the institution (or its counterparty) will deliver under the transaction, the institution should assume for the sake of prudence that it (or its counterparty) will select from the list the type of securities to be delivered in the following order:

1st: assets that do not qualify as HQLA;
2nd: level 2B assets that are not approved RMBS;
3rd: approved RMBS;
4th: level 2A assets; and
5th: level 1 assets.

Following the example provided in item B9 (in which case Bank B is the reporting institution for the purposes of item C3), Bank B's cash-flow positions arising from the securities swap transactions are reciprocal to those of Bank A. Therefore Bank B should report the expected cash inflow arising from the securities swap transactions in Table 4 as follows:

(HK$'000 equivalent)

	Type of securities to be received by reporting institution from counterparty within LCR period	Type of securities to be delivered by reporting institution to counterparty within LCR period	Principal amount of securities to be received by the institution	Weight	Weighted amount	Breakdown of weighted amount by currencies				
						HKD	USD	Other major $	RMB	Other $
(a)	level 1 assets	level 2A assets	1000	15%	150	150	0	0	0	0
(g)	level 2A assets	assets that are not level 1 assets, level 2A assets or level 2B assets	780	85%	663	0	663	0	0	0
(k)		**Sub-total**	1780		813	150	663	0	0	0

C4 Other loans not otherwise covered in Section (I)C

Report in this item the book value of repayments (including interest payments and instalments) from loans, whether secured or unsecured, that are contractually due within the LCR period (and not captured in other cash inflow items).

Report in sub-item 4(a) contractual cash inflows from revolving loans or loans without a specific maturity date. To avoid doubt, a loan drawn on a revolving facility should be reported in this sub-item[97], unless the loan (and the facility) will be fully repaid (and cancelled upon its expiry) within the LCR period because the institution has decided (as evidenced in the institution's credit records) that the facility will not be renewed and hence any outstanding loan balance will have to be settled by the borrower upon expiry of the facility within the LCR period. In such a situation, contractual cash inflows from settlement of the loan can be reported in sub-item 4(b).

Sub-item 4(b) captures contractual loan repayments not covered in sub-item 4(a) that fall due within the LCR period by type of borrower. To avoid doubt, whilst a loan that is revolving or does not have a specific maturity date is usually not captured in this sub-item (save for situations where a revolving loan can meet the conditions specified above), any periodic repayment of principal, interest, fee or other income generated from such loans can be included in this sub-item[98].

C5 Release of balances maintained by the reporting institution in segregated accounts for protection of customer assets

If the reporting institution is subject to any investor protection regulations that require the institution, upon receipt of assets (whether in cash or other assets) from customers for investment purposes, to maintain an amount of those assets as prescribed in those regulations in a segregated account (hence not including the customer assets in the institution's balance sheet), the institution may report the assets maintained in that segregated account as cash inflows under this item, provided that the assets are HQLA qualifying assets and will be released from the segregated account and payable to customers (hence already reported in the cash outflow item B6(b)) within the LCR period.[99]

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97 Ref: BCBS LCR FAQ (April 2014), no. 17

98 Ref: 2013 BCBS LCR Document (paragraph 152)

99 In Hong Kong, AIs are not subject to this type of investor protection rules. If, however, a category 1 institution has any locally incorporated specified associated entity which is a Licensed Corporation (and hence subject to the Client Money Rules under the Securities and Futures Ordinance), or the institution has any overseas branch or overseas specified associated entity which is subject to a similar type of rules in the jurisdiction concerned, this cash inflow item may be relevant to the institution if it calculates the LCR on an unconsolidated or consolidated basis covering the relevant associated entity or overseas branch.

C6 Securities held by the reporting institution maturing within the LCR period, and which do not qualify as HQLA

Report the book value of securities held by the reporting institution (including accrued interest) if the securities will be redeemed within the LCR period and they are not included in the stock of HQLA of the institution. Interest to be accrued (and receivable by the institution) within the LCR period should also be reported in this item.

C7 Undrawn facilities granted by other financial institutions

Report in this item the undrawn portion of any credit, liquidity or other facilities granted by other financial institutions, irrespective of whether the facilities are committed facilities. (Also provide the relevant details of such facilities in Part (III) of the Return on Liquidity Monitoring Tools (MA(BS)23).)

C8 Operational deposits placed at other financial institutions

Report in this item any amount of money placed by the reporting institution at other financial institutions if the institution is satisfied that the money placed is treated as operational deposits by those financial institutions. The methodology adopted by the institution for calculating this cash inflow item should be in line with the methodology adopted by it for determining the amount of operational deposits received by it (as referred to in item B5).

C9 Derivative contracts

Follow the CIs provided in **<u>Annex 5</u>** for completing Table 5 of Section (II) of this Part, which will generate the required figures for this item.

C10 Other contractual cash inflows generated from relevant financial activities (not otherwise covered in Section (II)C)

Report in this item other contractual cash inflows not covered in other cash inflow items by type of customer, provided that the inflows are generated from "relevant financial activities"[100] conducted by the reporting institution and expected to be received by the institution within the LCR period. This item may capture expected cash inflows arising from, for example, amounts receivable from transactions awaiting

[100] The definition of "relevant financial activity" in the BLR is largely in line with the existing definition provided in the BCR.

settlement, dividend receivable, interest receivable (if the interest has not been included elsewhere) within the LCR period.

In the case of uncollateralized securities lending transactions that will mature within the LCR period, the contractual cash inflow (either in cash or other HQLA qualifying assets) can be counted in this item. If the cash inflow is an asset that can qualify as a level 2A or level 2B asset upon receipt by the institution, report in this item the fair value of the asset (after applicable haircut).[101] If an uncollateralized securities lending transaction (or any similar transaction) does not have a definite term to maturity, assume the transaction will be carried forward beyond the LCR period, and therefore the cash inflow to be generated upon the settlement of the transaction cannot be included in the calculation of the LCR.

[101] Ref: BCBS LCR FAQ (April 2014), no. 16

PART 3: LIQUIDITY MAINTENANCE RATIO

[Note: This Part will be retained largely the same as the version published by the HKMA on 30 April 2014, save for some minor modifications and elaborations in response to the industry's comments. The HKMA will finalise the whole set of CIs including this Part after completing this round of consultation.]

PART 4: SUPPLEMENTARY INFORMATION

[Note: This Part will be removed.]

Hong Kong Monetary Authority

Parts 1 and 3	:	30 April 2014
Parts 1 (revised) and 2	:	15 September 2014

Annex 1
Framework for adoption of ALA Option 2 in Hong Kong[102]

Background

1. Pursuant to Division 4 of Part 7 of the BLR, a category 1 institution that is running a HKD LCR mismatch may adopt Option 2 of the Alternative Liquidity Approaches ("ALA Option 2") under the Basel III LCR framework by using HQLA (which must be level 1 assets) denominated in foreign currencies to cover its HKD LCR mismatch to the extent of meeting relevant requirements set out in section 38 of the BLR. Such requirements include –

    (i) having a genuine need[103] to use such HQLA (which have not already been used by the institution to cover its foreign currency-denominated total net cash outflows[104]) to comply with the minimum LCR requirement;

    (ii) possessing necessary systems and capacity to manage foreign exchange risk associated with the use of such HQLA; [105]

    (iii) always holding an amount of HKD-denominated HQLA[106] (which must be level 1 assets) that is not less than 20% of the institution's HKD-denominated total net cash outflows[107] ("20% minimum holding requirement"); and

    (iv) subjecting such HQLA to foreign exchange haircuts (as required under section 39 of the BLR).

2. It is not the MA's intention to require case-by-case approval of the use of ALA Option 2 by individual category 1 institutions. However, those institutions adopting ALA Option

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102 LM-1 (under revision) will provide supplementary guidance on the ALA framework where appropriate.

103 For example, there may be a practical difficulty to significantly change the currency composition of the institution's HQLA due to limited supply of HQLA denominated in HKD and other market circumstances.

104 Under the BLR, the term "foreign currency-denominated total net cash outflows" refers to a category 1 institution's total net cash outflows (before applying the 75% ceiling on total expected cash inflows) that are denominated in foreign currencies.

105 Please refer to relevant guidance set out in LM-2 re foreign currency liquidity management for details.

106 Under the BLR, the term "HKD-denominated HQLA" refers to the total weighted amount of HQLA held by a category 1 institution (before making any adjustment in respect of the 15% ceiling on level 2B assets and 40% ceiling on total level 2A and level 2B assets) that are denominated in Hong Kong dollars.

107 Under the BLR, the term "HKD-denominated total net cash outflows" refers to a category 1 institution's total net cash outflows (before applying the 75% ceiling on total expected cash inflows) that are denominated in Hong Kong dollars.

2 should be able to demonstrate their compliance with section 38 of the BLR for use of ALA Option 2 upon request by the MA.

Adoption of ALA Option 2 – Relevant parameters

3. The minimum LCR requirement (for the all-currencies LCR standard) will increase from 60% in 2015 to 100% in 2019 under the phase-in implementation timetable. Assuming that the same level of HKD liquidity coverage applies in respect of HKD-denominated HQLA versus HKD-denominated total net cash outflows, the maximum level of HKD LCR mismatch that can be covered by foreign currency-denominated HQLA under ALA Option 2 can be determined by reference to the 20% minimum holding requirement referred to in paragraph 1 of this Annex. That is, if the minimum LCR requirement is 100% (and the same level of HKD liquidity coverage is expected), the maximum usage of ALA Option 2 (or foreign currency-denominated HQLA) will be 80% (= 100% – 20%) of HKD-denominated total net cash outflows.[108]

4. The use of foreign currency-denominated HQLA to cover HKD LCR mismatch is subject to foreign exchange haircuts if the level of usage exceeds a certain threshold (as specified in section 39(2) of the BLR[109]). Such haircuts are – [110]

		Haircuts
(a)	Level 1 assets denominated in US dollars	2%
(b)	Level 1 assets denominated in other major currencies with global transaction volume exceeding 10% of total global foreign currency market turnover (i.e. EUR, JPY and GBP)	8%
(c)	Level 1 assets denominated in any other foreign currency that is freely convertible into Hong Kong dollars (including RMB assets that meet relevant qualifying criteria as HQLA)	10%

108 As noted from the BLR definitions of HKD-denominated HQLA, foreign currency-denominated total net cash outflows and HKD-denominated total net cash outflows, for the purposes of assessing the level of a category 1 institution's HKD LCR mismatch, and hence determining the maximum level of usage of ALA Option 2 (i.e. the maximum amount of foreign currency-denominated HQLA that may need to be used by a category institution to cover its HKD LCR mismatch), it is considered unnecessary (and inappropriate) to apply the 15% ceiling on level 2B assets, the 40% ceiling on total level 2A and level 2B assets as well as the 75% ceiling on total expected cash inflows. The application of the 15% and 40% ceilings in respect of the aggregate amount of HQLA (calculated on an all-currency basis) is to avoid undue reliance on level 2A or level 2B assets, whereas the application of the 75% ceiling on total expected cash inflows is to ensure that a category 1 institution always maintains a minimum stock of HQLA sufficient to cover at least 25% of its total expected cash outflows (even if the institution maintains a net positive inflow position). Therefore, these ceilings are not intended to be applied for ALA purposes.

109 As reflected from section 39(2) of the BLR, foreign exchange haircuts do not apply to the relevant portion (or that part of the relevant portion) of foreign currency-denominated HQLA, held by a category 1 institution to cover its HKD LCR mismatch, that is not more than 25% of the institution's HKD-denominated total net cash outflows.

110 Please refer to L3 (paragraph 59) for the underlying concepts and methodologies adopted by the HKMA to determine the respective haircuts for ALA purposes.

5. The threshold for application of foreign exchange haircuts will be 25% (in line with the Basel LCR standard) when the minimum LCR requirement reaches 100% on 1 January 2019. This means that the relevant portion of foreign currency-denominated HQLA subject to foreign exchange haircuts will not exceed an amount equivalent to 55% (= 100% – 20% – 25%) of HKD-denominated total net cash outflows. The threshold will be correspondingly adjusted based on the prevailing minimum LCR requirement during the phase-in period.

6. Based on the above reasoning, the relevant parameters in relation to the use of ALA Option 2 are summarised as follows:

	A	B	C	D	E
	Minimum. LCR requirement (=expected level of HKD liquidity coverage)	Precondition for using ALA Option 2: 20% minimum holding requirement for HKD-denominated level 1 assets	Allowable usage of F/C-denominated level 1 assets to cover HKD LCR mismatch under ALA Option 2 **(= A – B)**	Allowable level of cross-currency liquidity coverage (i.e. portion of **C** not subject to FX haircuts) = **Max(0, 25% - (100% - A))**	Portion of **C** subject to FX haircuts **(= C – D)**
2015	60%	20%	40%	Nil	40%
2016	70%	20%	50%	Nil	50%
2017	80%	20%	60%	5% (= 25% - (100% - 80%)	55%
2018	90%	20%	70%	15% (= 25% - (100% - 90%)	55%
2019 onwards	100%	20%	80% (max level set by BCBS)	25% (max level allowed by BCBS)	55%

7. The example below demonstrates the methodology underlying Table 2 of Section (II) of the Return for calculating the amount of haircuts on foreign currency-denominated level 1 assets if the reporting institution uses such assets to cover its HKD LCR mismatch.

(Unit: HKD'000 equivalent)

		Total	HKD	USD	Other major $	RMB	Other $
1	Total level 1 assets (before deductions) (= Section (I), sub-item A1(f)	320	120	20	10	50	120
2	Total level 2A assets (before deductions) (= Section (I), sub-item A2(d))	240	30	50	80	20	60
3	Total level 2B assets (before deductions) (= Section (I), sub-item A3(c))	10	0	0	10	0	0
4	Total HQLA (before deductions) (= Section (I), item A4)	570	150	70	100	70	180
5	Total expected cash outflows (= Section (I), item B23)	1050	500	200	150	100	100
6	Total expected cash inflows (before application of 75% inflow ceiling) (= Section (I), item C11)	520	100	120	100	120	80
7	Amount of HKD LCR mismatch (= Max(item 13*(item 5 – item 6) – item 4, 0))		90				
8	The portion of HKD LCR mismatch which, if covered by foreign currency assets, needs to be subject to additional haircut on the foreign currency assets (=If (item 7 = 0, 0, item 7 – Max(item 5 – item 6,0)* Max(0,25% – (100% – item 13)))		90				
9	Level of holding in HKD level 1 assets meets 20% minimum holding requirement: ("Yes" if HKD LCR mismatch ratio =/> 20%; "No" if < 20%; N/A if HKD LCR mismatch does not exist)	Yes / No/ N/A					
10	Surplus amount of level 1 assets in foreign currencies (if any) (=Min (Max (item 4 – item 13* Max (item 5 – item 6,0),0), item 1))			20	10	50	120
11	Relevant portion in item 10, used to cover HKD LCR mismatch calculated in item 8 does not align with Table 2]			20	10	50	10
12	Deduction from total HQLA - additional adjustment due to foreign exchange haircuts [to be mapped to Section (I), item A6]	 **7.2**		2% **0.4**	8% **0.8**	10% **5**	10% **1**
13	**Memorandum item:** Minimum required level of LCR for the reporting period	[60%]					

Explanatory Notes

- The figures in items 1 to 6 are copied from those reported by a category 1 institution in Section (I). In this example, the institution has a HKD LCR mismatch of HK$90 (item 7). If the institution uses foreign currency-denominated HQLA (which must be level 1 assets) to cover this amount of HKD LCR mismatch, a portion of these foreign currency-denominated HQLA (equivalent to HK$90 as indicated in item 8) will be subject to foreign exchange haircuts.

- Item 9 reflects whether the reporting institution is able to meet the 20% minimum holding requirement for HKD-denominated HQLA (which must be level 1 assets). If the institution is unable to observe this requirement, it must notify the HKMA immediately, so that the HKMA may deliberate appropriate supervisory measures to cater for this situation.[111]

- Item 10 calculates the surplus amount of foreign currency-denominated level 1 assets that can be used to cover HKD LCR mismatch. In this example, the reporting institution has surplus level 1 assets in USD (equivalent to HK$20), other major currencies (equivalent to HK$10), RMB (equivalent to HK$50) and other currencies (equivalent to HK$120).

- Item 11 determines the amount of foreign currency-denominated level 1 assets that are actually required to cover HKD LCR mismatch. In determining the order of usage of foreign currency-denominated HQLA to cover HKD LCR mismatch, it is assumed that foreign currency assets that are subject to the lowest foreign exchange haircut will be utilised first, followed by other foreign currency-denominated assets by an ascending order of the level of foreign exchange haircut applicable to those assets under the ALA framework. The order of usage is assumed to follow this order: (i) USD, (ii) other major currencies (EUR, JPY, GBP); (iii) RMB; and (iv) other currencies. In this example, the surplus level 1 assets denominated in USD (HK$20) will be utilised first, followed by the level 1 assets denominated in other major currencies (HK$10), then level 1 assets denominated in RMB (HK$50) and finally level 1 assets denominated in other currencies (up to an amount equivalent to HK$10, which is used to cover the remaining portion of HKD LCR mismatch that has yet been covered after using all surplus assets in USD, other major currencies and RMB).

[111] The HKMA will elaborate on the possible supervisory measures in statutory guidelines (e.g. LM-1). Such measures may include, for example, temporarily allowing the institution concerned to use foreign currency-denominated assets to cover HKD LCR mismatch to the extent of exceeding the level indicated in column E of the Table under paragraph 6 of this Annex, but requiring the institution to observe an internal target level of LCR (which is reasonably above the statutory minimum level) and, where necessary, enhance its risk management systems to avoid falling below the 20% minimum holding requirement again.

- Item 12 calculates the total amount of foreign exchange haircuts resulting from the use of the relevant portion of foreign currency-denominated level 1 assets to cover HKD LCR mismatch. This total amount of foreign exchange haircut is mapped to item A6 of Section (I) for calculating the total amount of HQLA (after deductions).

Annex 2
Treatment of cash flows arising from forward contracts[112]

1. The term "forward contract" means a contract between two parties for entering into a transaction (e.g. to provide a loan of money, or to purchase, sell or exchange a specified quantity of a specified commodity, currency, financial instrument or thing) at a specified price on a specified future date ("Day F"). Some forward contracts may have a definite termination date ("Day T"). On Day F (and Day T where applicable), the counterparties to the contract will incur cash (or asset) inflows or outflows, which should be treated under the LCR according to the requirements set out below.

2. If the reporting institution has entered into a forward contract with a counterparty where Day F falls within the LCR period and Day T falls outside the LCR period (or Day T is not specified in the contract), the institution should report –

   (i) in item B22, the contractual cash outflow to be paid by the institution on Day F[113]. If the institution will receive an HQLA qualifying asset on Day F under the forward contract (e.g. in the case of a forward asset purchase contract in which the institution is the asset buyer or a forward reverse repo contract in which the institution will receive collateral from the counterparty), the fair value of that asset (after application of haircuts in the case of a level 2A or level 2B asset) may be deducted from the contractual cash outflow arising from the contract; or

   (ii) in item C10, the contractual cash inflow to be received by the institution on Day F. If the institution will deliver an HQLA qualifying asset on Day F under the forward contract, and the institution has counted that asset as HQLA (or has already re-hypothecated that asset to obtain funding), the fair value of that asset (after application of haircuts in the case of a level 2A or level 2B asset) should be deducted from the contractual cash inflow arising from the contract.

3. If Day F and Day T of a forward contract both fall within the LCR period, this contract is not considered under the LCR.[114] If Day F of the contract had occurred before the

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[112] The guidance provided in this Annex is developed by reference to the BCBS FAQ (April 2014) (no. 15), with appropriate modifications, to enable general application to all forward contracts. It is noted that the BCBS FAQ is mainly addressing forward repo, forward reverse repo, forward collateral swap and forward asset purchase (or sale) contracts.

[113] Or, in case of a forward securities swap transaction, report in item B22, the fair value of the asset to be delivered by the institution on Day F, net of the fair value of any HQLA qualifying asset to be received by the institution on Day F (after application of haircuts in the case of a level 2A or level 2B asset).

[114] This treatment is provided in BCBS FAQ (April 2014) (no. 15) based on a simplified assumption that the cash flow to be generated on Day F (when the transaction is executed) and the opposite cash flow to be generated on Day T (when the transaction is terminated) will be offset exactly within the LCR period. The

start of the LCR period whereas Day T of the contract falls within the LCR period, the contract can be treated as a spot contract. The cash flows to be accounted for on Day T should be reported according to applicable requirements.[115]

reporting institution should however notice that this assumption may not always be valid in the light of the possibility that (1) there may be a difference between cash inflows and outflows generated at different points of time, or (2) there exists a time gap between Day F and Day T even though these two points of time both fall within the LCR period. The institution should manage the relevant liquidity risks that are not captured under the LCR.

115 For example, if a forward repo contract was executed on Day F which is prior to the LCR period and Day T falls within the LCR period, the contract should be captured in item B8 (instead of item B22) of Section (I) of Part 2 of this Return.

Annex 3
Completion instructions for Table 1 of Section (II) – Determination of adjustments to HQLA for 15% ceiling on level 2B assets and 40% ceiling on level 2A and level 2B assets

1. If the reporting institution has entered into any securities financing transaction[116] which will necessitate the exchange of an asset for another asset, both of which are eligible for inclusion as HQLA[117], within the LCR period, complete sub-items 2(d) to 2(f) of Table 1 (re adjusted level 1, level 2A and level 2B assets) by reversing the effect of the securities financing transaction from the institution's HQLA positions, as if the exchange of the two HQLA qualifying assets were executed on the day when the LCR is calculated. Table 1 will generate the necessary figure for reporting of item A5 in Section (I) of Part 2 of this Return. If the institution has not entered into any such transaction, the institution should report sub-items 2(d) to 2(f) of Table 1 in the same amounts as those derived in sub-items 1(f), 2(d) and 3(c) in Section (I)A of Part 2 of this Return.

2. An illustrative example for the completion of sub-items 2(d) to 2(f) in Table 1, as well as the calculation of adjustments to HQLA for the 15% and 40% ceilings is provided below. To avoid doubt, the amounts shown in all diagrams in this Annex are "weighted" (i.e. after applying the haircuts applicable to the assets).

2.1 Bank X has maintained the following positions in HQLA holdings:

(Unit: HKD'000 equivalent)

Diagram 1	Total	HKD	USD	Other major $ (Euro, JPY, GBP)	Other currencies (incl. RMB)
Level 1 assets	2100	1000	600	500	0
Level 2A assets	1600	900	700	0	0
Level 2B assets	1900	800	800	300	0
Total HQLA (before applying the 15% ceiling & 40 % ceiling)	5600	2700	2100	800	0

2.2 Some of the above assets are obtained through the two securities financing transactions specified below, which will be due for settlement within the LCR period.

(Unit: HKD'000 equivalent)

Diagram 2	Receivable upon settlement	Payable upon settlement
(1) securities reverse repurchase transaction	level 1 asset in USD (post-haircut fair value equivalent to HKD100)	Level 1 asset in HKD (post-haircut fair value is equal to HKD110)
(2) securities swap transaction	level 2A asset in JPY (post-haircut fair value equivalent to	level 2B assets in USD (post-haircut fair value equivalent to

[116] "Securities financing transaction" is defined in the BLR as a repo-style transaction or a margin lending transaction.

[117] This means that all relevant requirements set out in section 26 of the BLR are met by the asset concerned, or by the institution holding the asset in so far as those requirements relate to the asset.

Diagram 2	Receivable upon settlement	Payable upon settlement
	HKD200)	HKD220)

2.3 If the two securities financing transactions are reversed, Diagram 1 will be adjusted as follows (whilst the figures in yellow cells should be reported in items 2(d) to 2(f) of Table 1):

(Unit: HKD'000 equivalent)

Diagram 3	Total	HKD	USD	Other major $ (euro, JPY, GBP)	Other currencies (incl. RMB)
Level 1 assets (adjusted)	2090	890	700	500	0
Level 2A assets (adjusted)	1800	900	700	200	0
Level 2B assets (adjusted)	1680	800	580	300	0
Total adjusted HQLA (before applying 15% ceiling & 40 % ceiling)	5570	2590	1980	1000	0

3. Using the above example, Table 1 will calculate the adjustment figures for the 15% ceiling and 40% ceiling by adopting the following steps:

3.1 Step 1: Before reversing any securities financing transaction, calculate the adjustments using the figures in Diagram 1 –

Adjustment for 15% ceiling
= Max (level 2B assets – 15/85*(level 1 assets + level 2A assets), level 2B assets – 15/60* level 1 assets, 0) = Max (1900 – 15/85*(2100 + 1600), 1900 – 15/60*2100, 0) = 1375

Adjustment for 40% ceiling
= Max ((level 2A assets + level 2B assets - adjustment for 15% ceiling) - 2/3* level 1 assets, 0)
=Max ((1600 + 1900 – 1375) – 2/3*2100, 0) = 725

Total adjustments for 15% ceiling and 40% ceiling = 1375+725 = 2100

Bank X's HQLA position (before reversing securities financing transactions) is adjusted as follows after applying the 15% ceiling and 40% ceiling:

(Unit: HKD'000 equivalent)

Diagram 4	Total	HKD	USD	Other major $ (euro, JPY, GBP)	Other currencies (incl. RMB)
Level 1 assets	2100				
Level 2A assets	~~1600~~ 1400				
Level 2B assets	~~1900~~ 0				
Total HQLA (before applying 15% ceiling & 40% ceiling)	~~5600~~ 3500				

3.2 Step 2: After reversing securities financing transactions, calculate the adjustments for the 15% and 40% ceilings using the figures in Diagram 3 –

Adjustment for 15% ceiling
= Max (level 2B assets – 15/85*(level 1 assets + level 2A assets), level 2B assets – 15/60* level 1 assets, 0) = Max (1680 – 15/85*(2090 + 1800), 1680 – 15/60*2090, 0) = 1158

Adjustment for 40% ceiling
= Max ((level 2A assets + level 2B assets - adjustment for 15% ceiling) - 2/3* level 1 assets, 0);
= Max ((1800 + 1680 – 1157.5) – 2/3*2090, 0) = 929

Total adjustments for 15% ceiling and 40% ceiling = 1158+929 = 2087

Bank X's HQLA position (after reversing securities financing transactions) is adjusted as follows after applying the 15% ceiling and 40% ceiling:

(Unit: HKD'000 equivalent)

Diagram 5	Total	HKD	USD	Other major $ (euro, JPY, GBP)	Other currencies (incl. RMB)
Level 1 assets (adjusted)	2090				
Level 2A assets (adjusted)	~~1800~~ 1393				
Level 2B assets (adjusted)	~~1680~~ 0				
Total adjusted HQLA (after applying 15% ceiling & 40% ceiling)	~~5570~~ 3483				

3.3 Step 3: The more conservative outcome shown in Diagram 4 and Diagram 5 (i.e. HKD 3483 in this example) should be reported in item A5 of Section (I) of this Return.

3.4 If Bank X has not entered into any securities financing transaction, the figure to be reported in item A5 of Section (I) should be HKD2100 (as calculated under paragraph 3.1 of this Annex.

Annex 4
Treatment of deposits taken by deposit-taking companies under the LCR

1. The CIs set out in this Annex apply to category 1 institutions (or their specified associated entities in the case of AIs incorporated in Hong Kong) which are deposit-taking companies.

2. Pursuant to section 12(3) of the BO, "*A deposit-taking company shall not, without the written permission of the Monetary Authority, repay any deposit within a period of less than three months (as specified in the First Schedule to the BO) from the date on which the deposit was taken by the company.*" Nonetheless, this legal prohibition from early repayment of a deposit taken by a deposit-taking company (DTC) does not apply in the following situations:

   (a) if the deposit has already been held by the DTC for three months or more from the date on which the deposit was taken by the DTC; and

   (b) if the deposit has not been held by the DTC for three months or more from the date on which the deposit was taken by the DTC, but the MA has granted a written permission under section 12(3) for early repayment of the deposit.

Treatment for deposits subject to section 12(3) restriction

3. Deposits taken by a DTC with a remaining term to maturity that is beyond the LCR period (even though such deposits have been held by the DTC for less than three months) can be excluded from the calculation of the LCR, provided that no section 12(3) permission has been granted by the MA in respect of those deposits.[118]

Treatment for deposits not subject to section 12(3) restriction (due to holding of deposits for three months or more)

4. If deposits taken by a DTC have been held by a DTC for three months or more, the section 12(3) restriction does not apply to those deposits. The outflow treatment of those deposits should follow the CIs set out in item B1, B3, B5 or B6 of Section (I) of Part 2 of this Return as appropriate. That is,

[118] This is a special treatment for "retail term deposits" taken by DTCs (otherwise those deposits will be subject to a 5% outflow rate). In the case of "unsecured wholesale funding" obtained by a DTC subject to the LCR, if the relevant conditions set out in Clause 6(1) and (2) of the CoP (e.g. the earliest possible contractual maturity date falls within the LCR period) are not satisfied, the funding concerned is already not required to be included for the purposes of calculating the LCR.

(a) retail deposits (other than retail term deposits) taken by a DTC that will mature within the LCR period should be treated as "less stable retail deposits" and hence reported in sub-item B1(b), given that deposits taken by DTCs are not protected by the Deposit Protection Scheme in Hong Kong and therefore do not qualify as "stable retail deposits". Similarly, small business funding obtained by a DTC that will mature within the LCR period should be reported in sub-item B3(b);

(b) retail term deposits taken by a DTC that will mature beyond the LCR period should be reported in sub-item B1(c). Similarly, small business funding obtained by a DTC that will mature within the LCR period should be reported in sub-item B3(c);

(c) other deposits taken by a DTC (e.g. from wholesale customers which are not small business customers) that will mature within the LCR period should be reported in item B5 or B6 as the case may require.

Treatment for deposits not subject to section 12(3) (by virtue of MA's written permission under section 12(3))

5. If section 12(3) does not apply to a deposit taken by a DTC because of the MA's written permission to allow early repayment of the deposit under section 12(3), the deposit should be subject to an outflow rate of 100% (given the high likelihood that the deposit will be repaid soon after the MA's permission is granted). Report the deposit in the following item or sub-item under Section (I)(B) of this Return:

(a) item B22 (i.e. other contractual cash outflows) if the deposit is a retail deposit or small business funding;

(b) sub-item B6(b) (i.e. unsecured wholesale funding other than funding covered under item B3, B4, B5 or B6(a)) if the deposit is unsecured wholesale funding (other than funding covered under item B3, B4, B5 or B6(a)).

6. The above CIs are summarized as follows:

<table>
<tr><th rowspan="2"></th><th colspan="2">Term deposits taken from retail or small business customers</th><th colspan="2">Term deposits taken from wholesale customers (other than small business customers)</th></tr>
<tr><th>Remaining term within LCR period</th><th>Remaining term exceeding LCR period</th><th>Remaining term within LCR period</th><th>Remaining term exceeding LCR period</th></tr>
<tr><td>Restricted by s.12(3)</td><td rowspan="2">Counted as “less stable retail deposits” (sub-item B1(b)) or “less stable small business funding” (sub-item B3(b)), subject to 10% outflow rate</td><td>Not counted</td><td rowspan="2">Counted in item B5 or B6 according to usual requirements</td><td rowspan="3">Not counted</td></tr>
<tr><td>Not restricted by s.12(3) because the 3-month restriction has been fulfilled</td><td>Counted as “retail term deposits” (sub-item B1(c) or “small business term funding” (sub-item B3(c)), subject to 5% outflow rate</td></tr>
<tr><td>Exempted from s.12(3) by MA</td><td colspan="2">Counted as “other contractual cash outflows” (item B22), subject to 100% outflow rate</td><td>Counted in sub-item B6(b), subject to 100% outflow rate</td></tr>
</table>

Annex 5

Completion instructions for Table 5 of Section (II) – Calculation of expected cash outflow and inflow arising from derivative contracts

1. Follow the steps below to complete Table 5, which will generate the required figures for reporting of cash outflow item B10 and cash inflow item C9 in Section (I) of Part 2.

2. Report in item 1 the **gross amount**, measured at fair value in accordance with the institution's usual valuation methodology, of (a) contractual cash outflows to be paid, and (b) contractual cash inflows to be received, by the reporting institution within the LCR period under derivative contracts entered into by the institution.

   For example, the reporting institution (Bank A) has entered into the following derivative contracts with its counterparty (Bank B):

(Unit: HKD'000 equivalent)

		Bank A	Bank B	Applicable exchange rates
Contract (I)	Inflow (IF): Outflow (OF):	USD130 EUR100	EUR100 USD130	@ 7.8 HKD per USD @ 9.75 HKD per EUR
Contract (II)	IF: OF:	JPY 15000 GBP 100	GBP 100 JPY 15000	@ 12 HKD per GBP @ 7 HKD per AUD
Contract (III)	IF: OF:	HKD 630 AUD 100	AUD 100 HKD 630	@ 13.33 JPY per HKD

   Bank A should complete item 1 of Table 5 as follows:

(Unit: HKD'000 equivalent)

1. Derivative cash flows before adjustments	Principal amount (fair value)	Weight	Weighted amount	Breakdown of weighted amount by currencies				
				HKD	USD	Other major $	RMB	Other $
(a) Contractual cash outflows	2875		2875	0	0	2175 (EUR100*9.75) + (GBP100* 12)	0	700 (AUD100*7)
(b) Contractual cash inflows	2769		2769	630	1014 (USD130 * 7.8)	1125 (JPY15000 ÷13.33)	0	0

3. Report in item 2 the **adjusted amount**, measured at fair value, of (a) contractual cash outflows to be paid, and (b) contractual cash inflows to be received, by the reporting institution within the LCR period under derivative contracts entered into by the institution, if any of the adjustments set out below is applicable to the institution.

Adjustments for any HQLA collateral posted or received by the institution

3.1 If the reporting institution has posted any HQLA collateral to a counterparty to secure the institution's payment obligations under a derivative contract, the institution may offset the fair value of the posted collateral (after applying haircuts in the case of level 2A or level 2B assets) against the fair value of the contractual cash outflow to be paid by the institution under the contract. If the posted collateral is denominated in a currency which is different from that of the contractual cash outflow to be paid by the institution within the LCR period, convert the value of the posted collateral into the currency in which the contractual cash outflow is denominated.

3.2 Similarly, if the reporting institution has received any HQLA collateral from a counterparty to secure the counterparty's payment obligations to the institution under a derivative contract, and <u>the collateral is included by the institution as HQLA for calculating its LCR</u>, the institution must offset the fair value of the received collateral (after applying haircuts in the case of level 2A or level 2B assets) against the fair value of the contractual cash inflow to be received by the institution under the contract. If the received collateral is denominated in a currency which is different from that of the contractual cash inflow to be received by the institution within the LCR period, convert the value of the received collateral into the currency in which the contractual cash inflow is denominated.

3.3 For example –

(i) If Bank A has posted a USD-denominated level 2A asset with a fair value of USD100 (equivalent to HKD780) to a counterparty as collateral to secure Bank A's payment obligations under Contract (I), Bank A is allowed to offset the post-haircut fair value of that asset (i.e. after applying a 15% haircut on the level 2A asset) against the contractual cash outflow to be paid by Bank A under Contract (I). The net amount of contractual cash outflow arising from Contract (I) is equivalent to HKD312 (=EUR100*9.75 – USD100*7.8*85%).

(ii) If Bank A has also received a HKD-denominated level 1 asset with a fair value of HKD1000 from a counterparty as collateral to secure the latter's payment obligations under Contract (II), and the collateral is included by Bank A as level 1 asset in calculating its LCR, Bank A must calculate the contractual cash inflow arising from Contract (II) by offsetting the fair value of the level 1 asset (0% haircut in this case) received by it. The net amount of contractual cash inflow arising from Contract (II) is equivalent to HKD125 (= JPY15000/13.33 – HKD1000).

After adjustments for the value of collateral posted or received by Bank A, item 2 of Table 5 should be reported as follows:

(Unit: HKD'000 equivalent)

2. Derivative cash flows after adjustments	Principal amount (fair value)	Weight	Weighted amount	Breakdown of weighted amount by currencies				
				HKD	USD	Other major $	RMB	Other $
(a) Contractual cash outflows (net of contractual cash inflows where applicable)	**2212**		**2212**	0	0	1512 (= **312** + 1200)	0	700
(b) Contractual cash inflows (net of contractual cash inflows where applicable)	**1769**		**1769**	630	1014	**125**	0	0

3.4 If the collateral posted or received by the reporting institution is specific to a derivative contract, the amount of collateral value to be deducted cannot exceed the amount of contractual cash outflow or contractual cash inflow generated from that contract.

3.5 If the reporting institution has posted a pool of assets (some of which may qualify for inclusion as level 1, level 2A or level 2B assets) as collateral to a counterparty to secure the institution's payment obligations under two or more derivative contracts, and there are no specific terms under the contracts regarding which of the assets within the pool should be assigned to cover which of the contracts, the institution should adopt the following assumptions:

(i) an asset within the pool of collateral is assumed to be used to offset the contractual cash outflow denominated in the same currency as that of the asset first;

(ii) any remaining value of that asset is assumed to be used to offset the contractual cash outflows denominated in other currencies according to this order: (a) HKD; (b) USD; (c) "other major currencies" (i.e. JPY, EUR and GBP); (d) RMB; and (e) other currencies; and

(iii) in determining the order of using different classes of asset in the pool of collateral posted by the institution to offset derivative cash outflows, the institution may apply this order: (a) assets that do not qualify as HQLA; (b) level 2B assets that are not approved RMBS; (c) approved RMBS; (d) level 2A assets; and (e) level 1 assets.[119]

[119] Ref: BCBS LCR FAQ (April 2014), no. 8(d)

3.6 For the purposes of reporting contractual cash inflows arising from derivative contracts, the assumptions set out in paragraph 3.5 should also be applied to the treatment of collateral received by the reporting institution under derivative contracts.

Offsetting of contractual cash flows under the same exchange rate contract

3.7 The contractual cash inflow and outflow arising from the same exchange rate contract[120] can be offset[121] if the two amounts are fully exchanged on a simultaneous basis (or within the same day) upon the settlement of the contract, irrespective of whether the contract is subject to a valid bilateral netting agreement.[122]

In the above example, assume that all of the derivative contracts between Bank A and Bank B are exchange rate contracts and, for each contract, the contractual cash outflow and inflow (after adjustment of collateral value if any) can be offset. Then the respective cash-flow positions of Bank A and Bank B under each of the contracts are adjusted as follows:

(Unit: HKD'000 equivalent)

	Bank A	Bank B
Contract (I)	Net inflow = (USD130*7.8) – (EUR100*9.75 – USD100*7.8*85%) = 702 (reported in currency column according to the currency denomination of the largest inflow leg, i.e. USD)	Net outflow = 702
Contract (II)	Net outflow = (JPY15000/13.33 – HKD1000) – (GBP100*12) = 1075 (reported in the currency column according to the currency denomination of the largest outflow leg, i.e. GBP)	Net inflow = 1075
Contract (III)	Net outflow = HKD630 – AUD100*7 = 70 (report in the currency column following the currency denomination of the largest outflow leg i.e. AUD)	Net inflow = 70

[120] The term "exchange rate contract" is as defined in section 2 of the BCR. In brief, it includes –

(a) a forward foreign exchange contract, cross-currency interest rate swap contract, currency option contract or similar derivative contract; and

(b) a forward contract, swap contract, option contract or similar derivative contract, the value of which is determined by reference to the value of, or any fluctuation in the value of, gold.

[121] This offsetting treatment for exchange rate contracts is based on the *"Frequently Asked Questions on Basel III's January 2013 Liquidity Coverage Ratio framework"* published by the BCBS in April 2014 (FAQ no. 8(e)). This document is available at: http://www.bis.org/publ/bcbs199.pdf

[122] The term "valid bilateral netting agreement" is as defined in section 2 of the BCR.

Bank A should report in item 2 as follows:

(Unit: HKD'000 equivalent)

2. Derivative cash flows after adjustments	Principal amount (fair value)	Weight	Weighted amount	Breakdown of weighted amount by currencies				
				HKD	USD	Other major $	RMB	Other $
(a) Contractual cash outflows (net of contractual cash inflows where applicable)	1145		1145	0	0	1075	0	70
(b) Contractual cash inflows (net of contractual cash outflows where applicable)	702		702	0	702	0	0	0

Offsetting of contractual cash flows across derivative contracts subject to a valid bilateral netting agreement

3.8 Contractual cash outflows and inflows arising from derivative contracts entered into by the reporting institution with the same counterparty within the LCR period can be calculated on a net basis if the contracts are subject to a valid bilateral netting agreement entered into by the institution with that counterparty.

In the above example, if the three derivative contracts entered into by Bank A with Bank B are subject to a valid bilateral netting agreement, their respective net cash-flow positions under each of the contracts (as calculated under paragraph 3.7) can be offset further, as demonstrated below:

(Unit: HKD'000 equivalent)

	Bank A	Bank B
Contracts (I), (II) & (III)	Net outflow = 1075 + 70 – 702 = 443 (reported in the currency column according to the currency denomination of the largest outflow leg, i.e. GBP)	Net inflow = 443

Bank A should therefore report under item 2:

(Unit: HKD'000 equivalent)

2. Derivative cash flows after adjustments	Principal amount (fair value)	Weight	Weighted amount	Breakdown of weighted amount by currencies				
				HKD	USD	Other major $	RMB	Other $
(a) Contractual cash outflows (net of contractual cash inflows where applicable)	443	100%		0	0	443	0	0
(b) Contractual cash inflows (net of contractual cash outflows where applicable)	0	100%		0	0	0	0	0

Annex 6

Completion instructions for Table 6 of Section (II) – Calculation of expected cash outflow arising from potential loss in market value of posted collateral securing derivative contracts or other transactions

1. Report in item 1 of Table 6 the contracted amount of collateral (other than level 1 assets) posted by the reporting institution to its counterparty as required under a derivative contract or any other transaction (**"posted collateral"**). The contracted amount of posted collateral should be determined in accordance with the terms and valuation methodology that may be specified in the relevant contractual agreement.[123] For example, if the relevant contractual agreement requires the posted collateral to be measured at market value subject to any haircut, the institution should report the post-haircut market value of the posted collateral in item 1 of Table 6.

2. If the reporting institution has received collateral which is not level 1 asset **("received collateral")** from the same counterparty (i.e. the one who has received the posted collateral), report the contracted amount of the received collateral in item 2 of Table 6, provided that the institution has an unrestricted right to re-hypothecate the received collateral but has not done so, nor has the institution counted the received collateral as HQLA in calculating its LCR.

For example, Bank A (the reporting institution) has the following collateral positions arising from derivative contracts (or other transactions) entered into Bank B (the counterparty):

(Unit: HKD'000 equivalent)

Contract	Collateral (other than level 1 assets) (contracted amount in HKD equiv.)	HKD	USD	Other major $	RMB	Other $
(I)	Collateral posted	350	0	0	0	0
(II)	Collateral posted	0	1000	0	0	0
(III)	Collateral posted	0	0	0	250	0
(IV)	Collateral received	0	0	200	0	0
(V)	Collateral received	0	1100	0	0	0

Bank A should complete Table 6 as follows:

[123] Ref: BCBS LCR FAQ (April 2014), no. 9(a)

(Unit: HKD'000 equivalent)

	Contracted amount	Weight	Weighted amount	Breakdown of weighted amount by currencies				
				HKD	USD	Other major $	RMB	Other $
1 Collateral (excluding level 1 assets) posted by the reporting institution to counterparties under derivative contracts or other transactions (***posted collateral***)	1600 (= 350 + 1000 + 250)							
2 Collateral (excluding level 1 assets) received by the reporting institution from the same counterparties under derivative contracts or other transactions that can be deducted from item 1 (***received collateral***)	1300 (= 1100 + 200)							
3 Net amount of collateral (= Max (item 1 – item 2), 0)	300	20%	60	10	0	0	50	0

3. The currency breakdown under item 3 of Table 6 is derived on the basis of the following assumptions[124] –

(i) the received collateral denominated in a specific currency (e.g. USD) is used to offset with the posted collateral denominated in the same currency first.

In the above example,

(a) Bank A receives collateral denominated in USD (1100 HKD equivalent) which can cover the USD collateral posted by it fully (1000 HKD equivalent). An amount of "0" is therefore reported in the USD column; and

(b) likewise, Bank A receives collateral denominated in "other major currencies" (200 HKD equivalent) but no collateral in these currencies has been posted by it. Therefore an amount of "0" is also reported in the column of "other major currencies";

(ii) the remaining value of received collateral (if any), after covering the posted collateral in the same currency, can be used to offset posted collateral denominated in other currencies. In such cases, the reporting institution may assume that the remaining value of the received collateral is used to offset posted collateral denominated in other currencies by order of: (a) HKD; (b) USD; (c) "other major currencies" (i.e. JPY, EUR, and GBP); (d) RMB; and (e) other currencies.

In the above example,

(a) the remaining value of received collateral denominated in USD and other major currencies (after offsetting against posted collateral in the same currency) can be used to cover posted collateral in HKD first. Therefore an amount of "10" is reported in the column of HKD (10 = (350 – (1100 – 1000) – 200)*20%); and

(b) an amount of "50" is reported in the column of RMB (50 = 250*20%).

4. If the received collateral is kept in a segregated account opened by the counterparty with the reporting institution, the collateral in the account can only be used to offset outflows associated with payments that are eligible to be offset from the same account of the counterparty.

For example, if the USD-denominated collateral received by Bank A under Contract (V) (1100 HKD equivalent) is kept in a segregated account which is designated to cover payments under a specific contract exclusively (e.g. Contract (III), under which Bank A is obligated to post RMB-denominated collateral (250 HKD equivalent), the remaining value of USD-denominated collateral (1100 – 250) cannot be used to offset other collateral posted by Bank A. Therefore Bank A should report Table 6 as follows:

(Unit: HKD'000 equivalent)

		Contracted amount	Weight	Weighted amount	Breakdown of weighted amount by currencies				
					HKD	USD	Other major $	RMB	Other $
1	Collateral (excluding level 1 assets) posted by the reporting institution to counterparties under derivative contracts or other transactions (***posted collateral***)	1600 (= 350 + 1000 + 250)							
2	Collateral (excluding level 1 assets) received by the reporting institution from the same counterparties under derivative contracts or other transactions that can be deducted from item 1 (***received collateral***)	450 (= **250** + 200)							
3	Net amount of collateral (= Max (item 1 – item 2), 0)	1150	20%	230	30	200	0	0	0

[124] If the reporting institution intends to adopt internal assumptions and methodologies to report the currency breakdown of this cash outflow item in order to better reflect its liquidity risk profile and liquidity risk management practice, it should discuss with the HKMA in advance.

Adopting the assumptions set out in paragraph 3, the currency breakdown of item 3 in Table 6 is calculated as follows:

(i) HKD column: 30 = (350 – 200)*20%

(ii) USD column: 200 = (1000 – 0)*20%

(iii) RMB column: 0

5. In any circumstances, collateral received by the reporting institution from its counterparty should not be used to offset collateral posted by the institution to another counterparty.[125]

[125] Ref: BCBS LCR FAQ (April 2014), no. 9(c)