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HKMA’s response to HKAB’s comments on revision of SPM module LM-1 “Regulatory Framework for Supervision of Liquidity Risk”

General comments

	HKAB comment	HKMA response
1.	<p><u>Impact of LM-1 to other banking returns</u></p> <p>We request that the HKMA to reconfirm whether MA(BS)18 - Return on Selected Data for Liquidity Stress-testing and MA(BS)22 - Return on Intraday Liquidity Position of an Authorized Institution remained inapplicable to foreign bank branches in Hong Kong.</p>	<ul style="list-style-type: none">As noted in the Completion Instructions (CIs) for MA(BS)18 and MA(BS)22, only licensed banks incorporated in Hong Kong are required to complete these two returns. In other words, other authorized institutions (AIs) (including foreign bank branches) do not need to complete these two returns unless specifically required by the HKMA.
2.	<p><u>Effective date of implementation</u></p> <p>Although AIs are already complying with the LCR requirements, we request that the HKMA to provide further lead time for AIs to meet the additional requirements in LM-1 (e.g. establishing internal targets approved by the Board).</p>	<ul style="list-style-type: none">The requirements set out in the proposed revised version of SPM module LM-1 are predominantly a collation of the requirements that have already been set out in the HKMA’s previous circulars to AIs, including in particular “The HKMA’s Approach to Applying Some Key Requirements in the Banking (Liquidity) Rules” issued on 6 February 2015¹. As such, it is our expectation that AIs should already be meeting the requirements. (Please see also our response to item 9 below regarding the internal targets for LCR and LMR.)
3.	<p><u>Recommendation on HQLA</u></p> <p>We understand that the HKMA would like Category 2 AIs to hold a diversified pool of liquid assets. We are aware that the HKMA has directly requested a number of AIs to purchase HQLA up to a specified percentage of their deposits. We recommend that, if required, the HKMA should incorporate this HQLA minimum requirement directly</p>	<ul style="list-style-type: none">As provided in section 8 of SPM module LM-2, AIs (both category 1 and category 2 institutions) are expected to maintain a liquidity cushion which should, among other things, be largely made up of highly liquid and readily marketable assets and be sufficient to cover potential funding gap under liquidity stress scenarios. AIs are therefore already expected to be holding a diversified pool of liquid assets, and as part of HKMA’s ongoing supervision, we communicate with individual

¹ <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2015/20150206e3.pdf>

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	into the LMR regime rather than making bilateral requests of AIs.	AIs on our specific expectations in this regard taking into account their actual circumstances.
4.	<p><u>Similarities between MA(BS)1G and MA(BS)23</u></p> <p>We would like the HKMA to consider discontinuing MA(BS)1G - Return of Maturity Profile as the information collected, in respect of the on and off balance sheet items, is similar to that in Part 4 of MA(BS)23 - Return on Liquidity Monitoring Tools.</p>	<ul style="list-style-type: none"> As noted in our letter of 25 August 2015 to the Association (please refer to item 4 of Annex 2 to the letter), submission of the previous Return of Maturity Profile (MA(BS)1G) has not been mandatory since June 2005. AIs are instead required to submit their internal cash flow projections to the HKMA quarterly but some AIs have nonetheless chosen to use MA(BS)1G for that purpose. Furthermore, after reporting under Part 4 of Return MA(BS)23 commences (i.e. starting from the position of June 2016), AIs will no longer be required to submit their internal cash flow projections unless otherwise specifically requested by the HKMA.
5.	<p><u>Recommendation to the next review of the SPM module LM-2 on “Sound Systems and Controls for Liquidity Risk Management”</u></p> <p>Section 1.8 of the revised LM-1 reiterates the importance for AIs to also comply with the requirements under LM-2. We acknowledge that some of the fundamental principles of sound liquidity risk management in LM-2 are applicable to both category 1 and 2 institutions. However, the type of risk management controls may differ significantly for these institutions due to differences in the liquidity monitoring framework (e.g. LCR and LMR) and their size of business.</p> <p>In particular, category 2 institutions are required to comply with LMR</p>	<ul style="list-style-type: none"> The requirements set out in SPM module LM-2 are generally applicable to all AIs, and the HKMA will assess AIs’ compliance on a proportional basis having regard to their business and risk profiles (see paragraph 1.3.2 therein). As regards the “liquidity cushion” provisions in SPM module LM-2, the term “high-quality liquid asset” is not intended to be limited to “HQLA” as defined for the purposes of LCR (and this was clarified in our circular of 25 September 2013²). We are in the process of updating SPM module LM-2 and will amend the relevant text to avoid possible confusion. We will consult the Association on the proposed revisions to SPM module LM-2 shortly.

² <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2013/20130925e1.pdf>

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	<p>under the revised LM-1. However, the scope of liquid assets that can be included in the liquidity cushion as set out in LM-2 appears to be only relevant to category 1 institutions. We would like the HKMA to provide further guidance on which sections of LM-2 can be considered to be not applicable for category 2 institutions.</p>	
6.	<p><u>Alignment of LM-1 requirements with the Return of Liquidity Position (MA(BS)1E) completion instructions</u></p> <p>The Completion Instructions for the Return of Liquidity Position (MA(BS)1E) provides specific exclusions from qualifying liabilities for category 2 institutions but some of the exemptions have not been covered in LM-1. For consistency we request that the HKMA align LM-1 with the existing requirements under MA(BS)1E.</p> <ul style="list-style-type: none"> We request that LM-1 section 6.3.4(b) is revised to include the following exclusions from footnote 50 on page 46 of the Completion Instructions. This exclusion specifically relates to undrawn overdraft and credit card facilities granted by category 2 institutions which are currently disregarded when the AI determines the amount of its qualifying liabilities for LMR purposes. <p><i>“.....For LMR purposes, undrawn facility limits granted by an AI under overdraft and credit card facilities can be disregarded when the AI determines the amount of its qualifying liabilities. (This is because, as observed by the HKMA, the actual utilisation of the credit limits under these types of facilities appear to be relatively low as compared to that of other types of facilities.) This exception</i></p>	<ul style="list-style-type: none"> The SPM module LM-1 is to provide guidance on the overall application of the Banking (Liquidity) Rules, while the CIs for MA(BS)1E are to provide technical explanations to facilitate AIs’ completion of the Return. It is not intended that the content of these two documents should precisely duplicate each other. The exclusion of specific types of one-month liabilities (as set out in footnote 50 of the CIs) from the calculation of the LMR has been covered in paragraph 6.3.4 of SPM module LM-1, as this relates to the application of the BLR. As for the elaboration in respect of multi-purpose facilities and the sale or purchase of securities conducted by the reporting institution on behalf of the institution’s clients (including brokers), these items are more for the purpose of providing technical explanation and clarification and hence are better placed in the CIs.

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	<p><i>will not be applicable if an AI grants a multi-purpose facility that allows a customer to draw on various types of loans in addition to overdraft or credit card advances. For example, an AI's lending commitment under a trade-financing facility should be regarded as irrevocable notwithstanding the possibility that the customer may be allowed to draw overdraft advances under that facility.”</i></p> <ul style="list-style-type: none">• We request that LM-1 section 6.3.4 is updated to include the following exclusion from page 47 of the Completion Instructions. This specifically relates to the exclusion of certain transactions from the category 2 institutions' qualifying liabilities. <p><i>“In the case of the sale or purchase of securities conducted by the reporting institution on behalf of the institution's clients (including brokers), the amount payable to these clients arising from such transactions can be excluded from this item, even if the transactions are due for settlement within the LMR period.”</i></p>	

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Comments on specific sections

	Relevant extracts from the revised module LM-1	HKAB comment	HKMA response
7.	<p><u>3.3.3</u> Rule 10(1)(b) requires further that an AI incorporated in Hong Kong having any overseas branches must calculate its LCR or LMR additionally on an unconsolidated basis covering all of its business in Hong Kong and overseas branches, unless the MA is satisfied that the liquidity risk associated with the business of an AI's overseas branch is immaterial and hence approves, under rule 10(3)(a), the exclusion by the AI of any of its overseas branches from the calculation.</p>	<ul style="list-style-type: none"> • We appreciate the flexibility given in excluding the AI's overseas branches in the calculation of the LCR and LMR under rule 10(3)(a). We think that this exclusion should apply to the LCR or LMR on a consolidated basis. • In order to facilitate the application of these exclusions and to demonstrate to the HKMA that the liquidity risk associated with overseas businesses is immaterial, we believe it would be useful to provide some guidance (e.g., by way of criteria or thresholds) on the factors the HKMA will take into account in approving such exclusions. 	<ul style="list-style-type: none"> • The Basel LCR standard requires its application on a consolidated basis and does not provide for national authorities to allow a bank to exclude its branch (which is an integral part of the bank) from its consolidated position for LCR purposes. Accordingly, rule 11 of the BLR does not allow for such exclusion for LCR purposes (and equally for LMR purposes). • Discretion is however provided under the Basel LCR standard as regard its application to a bank's unconsolidated position, and rule 10(b) of the BLR has accordingly provided for the MA to approve an AI to exclude its overseas branch for calculating the LCR (or LMR) on an unconsolidated basis, if the MA is satisfied that the liquidity risk associated with the business of an AI's overseas branch is immaterial. In general, the MA may only grant this approval under limited circumstances, for instance, an AI's overseas branch has been inactive and will remain so for the foreseeable future. Paragraph 3.3.3 of SPM module LM-1 has been modified to provide clarification.
8.	<p><u>3.4.4</u> In the case of a liquidity event that</p>	<ul style="list-style-type: none"> • We acknowledge that if a liquidity event arises, the HKMA may need to 	<ul style="list-style-type: none"> • The remedial actions that the MA may require an AI to take, and any supervisory actions that the MA may

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	<p>constitutes a contravention of the BLR, the MA may, after holding discussions with the AI, issue a notice to the AI requiring it to take remedial action.</p> <p>To extent practicable, the MA will require the AI concerned to improve its liquidity position and rectify identified liquidity management problems within a reasonable timeframe.</p> <p>Where circumstances warrant, the MA may take more serious supervisory measures to maintain the general stability of depositors. E.g. ring-fencing the institution's business activities, reviewing the fitness and propriety of any person (including a controller, director, chief executive, or manager) in the institution and suspending or ultimately revoking the institution's authorization.</p>	<p>intervene as and when the conditions evolve. However, we would like the HKMA to clarify in the guidance how it would determine whether a liquidity event would require intervention and the type of remedial actions that may be taken.</p> <ul style="list-style-type: none"> We request that guidance should be included in LM-1 on the circumstances that would warrant the HKMA taking more serious supervisory measures and how it would assess the reasonableness of the timeframe for their remediation. 	<p>take, will very much depend on the nature of the liquidity event and the circumstances of the AI concerned in each individual case. It is therefore not practical to prescribe in more specific terms how and whether various possible actions would be taken in different circumstances in advance.</p> <ul style="list-style-type: none"> The provisions in the Banking Ordinance provide for the MA to discuss remedial actions with the relevant AI concerned in advance and this should provide ample opportunity for an AI to consider and make representations regarding reasonableness of the remedial actions and their proposed timeframe.
9.	<p><u>3.5.2</u> A category 1 institution's internal LCR target should be reviewed and approved by the Board (or a Board-level committee) of the institution at least</p>	<ul style="list-style-type: none"> The revised LM-1 requires the internal LCR target to be reviewed and approved by the Board or a Board-level committee. As the LCR is computed on a daily basis and may 	<ul style="list-style-type: none"> The setting by AIs of an internal LCR or LMR target was discussed in our circular of 6 February 2015. An AI should arrange for its Board (or a Board-level committee) to review and approve its internal LCR or LMR target as soon as possible if this has not

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	<p>annually. The review should take into account, among other relevant factors, the annual increments in the minimum requirement during the phase-in period (2015 to 2018) and the historical trend of the institution’s LCR positions. For example, if a category 1 institution has maintained an LCR at a relatively low level or has exhibited a volatile trend in its LCR over a considerable period of time (say, during the past 12 months), it may need to provide for a more prudent “safety cushion” in its internal LCR target to ensure ongoing compliance with the regulatory minimum LCR requirement.</p>	<p>experience bouts of volatility during market stress, there may be instances where an AI will temporarily fall below its internal LCR target, while remaining above the statutory minimum requirement. This may occur temporarily as the AI manages its liquidity position (e.g. by disposing of HQLA). A similar scenario in relation to temporarily falling below the statutory minimum LCR when disposing of HQLA is also envisioned by Part 2, Rule 4, section (3) of the Banking (Liquidity Rules).</p> <ul style="list-style-type: none"> • If such scenarios occur and timely approval by the Board or a Board-level committee cannot be obtained due to practical constraints, we recommend that the HKMA allow senior management (for example through Treasury) to review and approve the internal LCR target and be given the authority to approve temporary breaches of the internal LCR target. Such targets and breaches can then be reported to the 	<p>already been done.</p> <ul style="list-style-type: none"> • Given that an AI’s internal LCR or LMR target is an important tool for ensuring the AI’s compliance with the minimum statutory requirement, it is expected that any adjustment of the target should be well justified and documented and approved by the Board (or a Board-level committee). • An AI should handle any failure to maintain its pre-determined LCR or LMR target in accordance with its own established internal procedures (including whether and how the case is to be reported to the Board) taking into account the nature, frequency and materiality of the shortfall. • The setting of an internal target and the process adopted in case of failure to meet and maintain the target level are two different things. It would appear imprudent for an AI to lower its internal LCR or LMR target to “rectify” shortfalls instead of addressing the cause of the shortfalls. • As regards the need to inform the HKMA of any “breach” of internal LCR or LMR target, we propose to clarify this in paragraph 3.5.6 of the SPM module LM-1 by adding: “To facilitate our risk-based supervisory monitoring, an AI is expected to inform the MA when its LCR or

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		<p>Board or a Board-level committee as soon as practicable.</p> <ul style="list-style-type: none"> We would like to clarify whether AIs are required to notify the HKMA if their internal LCR target is breached. In addition, we would like to understand what consequences and/or expected actions may be taken if this occurs. 	<p>LMR has fallen below its internal target level and has remained close to the statutory minimum required level for a considerable period of time (e.g. less than 5% above the statutory minimum required level for three consecutive days).” and with a footnote: “This expectation to inform the MA does not replace any formal notification requirement under the BLR.”</p>
10.	<p><u>3.5.5</u> In line with the requirements set out in SPM module LM-2 (sections 4 and 5), each AI should conduct regular projections and stress-testing of its LCR or LMR position as part of its liquidity risk management process, in order to identify risk drivers that may lead to drastic fluctuations in its LCR or LMR.</p> <p>In addition, AIs should formulate prudent metrics and internal limits (e.g. making reference to LCR by currencies, or to cash flows in tenor buckets that are more granular than those required by the LCR/LMR) as supplementary controls to ensure compliance with the LCR or LMR</p>	<ul style="list-style-type: none"> We think that the monitoring frequency in conducting internal projections and stress-testing of the LCR/LMR could vary depending on an AI’s size and business nature. This is also acknowledged in the HKMA’s Supervisory Policy Manual IC-5. We would like the HKMA to provide its view on the minimum acceptable frequency for carrying out projections and stress-testing on LCR/LMR during normal market conditions. We agree to the HKMA’s suggestion of formulating prudent metrics and internal limits as supplementary 	<ul style="list-style-type: none"> We do not intend to be prescriptive on the frequency of stress tests (including in respect of LCR or LMR positions) to be conducted by AIs. This should be determined by individual AIs taking into account their business nature and liquidity risk profiles. We observe that AIs generally conduct stress tests on a monthly basis, and some do so more frequently, say weekly or daily. For example, an AI with a less stable balance sheet structure and maturity mismatch profile may need to monitor and stress-test its liquidity positions (including its LCR or LMR position) more frequently. Whether a particular risk monitoring metric is suitable for use by an AI very much depends on the business nature and liquidity risk profile of the AI. The examples cited by the Association could all be

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	<p>requirements and enhance resilience to possible liquidity stress.</p>	<p>controls. We request clarification from the HKMA as to whether the following approaches to monitoring liquidity through limits and ratios are appropriate methods of meeting this requirement:</p> <ul style="list-style-type: none"> - Metrics and limits on a shorter time horizon than the 1 month LCR or LMR; - Internal foreign currency limits; or - Ratios of HQLA compared to net cash outflows. 	<p>appropriate metrics that may facilitate liquidity risk management and monitoring. Other examples are provided in section 3 of SPM module LM-2.</p>
11.	<p><u>4.2.2</u> <u>Ground 1: The AI is internationally active</u>. In determining whether an AI is internationally active, the MA will assess the level of the AI's international exposure, as measured by the aggregate amount of its external claims and liabilities, against a quantitative benchmark.¹²</p> <p><u>Footnote 12:</u></p> <p>.....For the purpose of initial designation of category 1 institutions to accommodate with the local commencement of the LCR</p>	<ul style="list-style-type: none"> • We understand from members that a number of banks have large placements and borrowings with other branches within their group. As these placements and borrowings are managed and accounted for on a gross basis, these represent a significant proportion of total assets. We are concerned that for this type of institution, a HK\$250 billion threshold may not be an appropriate indicator of whether such AIs are “internationally active”. We recommend that the 	<ul style="list-style-type: none"> • As discussed in the HKMA’s previous consultation papers on “Implementation of Basel III Liquidity Standards in Hong Kong” (i.e. L2 and L3 issued in June 2012 and July 2013 respectively), an AI’s external claims and liabilities arising from intragroup transactions are included in the assessment of its international exposures because such intragroup transactions may channel risks from overseas markets to the AI. Intragroup transactions were taken into account in determining the quantitative threshold of HK\$250 billion. Excluding intragroup transactions would warrant adjusting (lowering) this quantitative threshold correspondingly. There does not seem to

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	<p>requirement from January 2015, the MA, after consulting the local banking sector, set the quantitative benchmark HK\$250 billion in order to assess whether an AI should be regarded as being "internationally active" by reference to the level of its international exposure. This benchmark will be subject to review from time to time, taking into account the prevailing circumstances of the local banking sector, including (but not limited to) the medium-to-long-term trend of the banking sector's aggregate amount of international exposure.</p>	<p>HKMA adjust this threshold to exclude inter group placements and borrowings.</p>	<p>be a strong case for such a change and we are minded to retain the threshold for the time being.</p>
12.	<p><u>4.4.1</u> Decision by the MA under rule 3(1) and (5) may be made upon an application by an AI. Upon receipt of the AI's application for designation as a category 1 institution, the MA will approve the application pursuant to rule 3(1) if-</p> <p>(a) Any of the Specified Grounds is applicable to the AI; or</p>	<ul style="list-style-type: none"> We understand that an AI designated as a Category 2 institution may submit an application to the HKMA for designation as a Category 1 institution. This designation will then subject the institution to the LCR requirements instead of the LMR. We note that overseas regulators have reduced the minimum LCR for institutions that are headquartered 	<ul style="list-style-type: none"> As discussed in our previous consultation papers and our circular of 6 February 2015, rule 3(2)(b)(ii) is intended to provide an option for an AI to apply the LCR standard if there is reasonable justification for it to do so <u>and</u> the AI has the capacity (including systems and resources) to comply with <u>all</u> the provisions of the BLR that apply to category 1 institutions generally. Please refer to the grounds for designating an AI as a category 1 institution (on application) as provided in Part 2 of Schedule 1 to the

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	<p>(b) The MA is satisfied that both the grounds set out in Part 2 of Schedule 1 to the BLR are applicable to the AI. This means that the AI’s particular circumstances provide reasonable justification for it to be designated as a category 1 institution;²⁰ and the AI has the capacity (including systems and resources) to comply with the LCR requirements.</p> <p><u>Footnote 20:</u> For example, an AI being a part of a foreign banking group which implements the LCR at the group level, may have a case to seek designation by the MA as a category 1 institution for the sake of consistency with its group’s liquidity risk management framework.</p>	<p>overseas. This recognizes that the parent banking groups of these foreign entities would likely also set aside liquid assets for the liquidity needs attributable to their local operations. For instance, the Monetary Authority of Singapore and the Australian Prudential Regulatory Authority have reduced their minimum LCRs for these institutions to 50% and 40% respectively. We recommend that the HKMA incorporates a similar reduction to the minimum LCR for this type of institutions.</p> <ul style="list-style-type: none"> • We also understand that prior to approving a Category 2 institution’s application for Category 1 status, the HKMA will need to be satisfied that the AI has the capacity to comply with the LCR requirements prior to approval. In order for AIs to provide suitably robust applications, we would like the HKMA to provide further guidance on the type of information that will be required. 	<p>BLR.</p> <ul style="list-style-type: none"> • If an AI intends to apply for designation as a category 1 institution, it should provide sufficient information to demonstrate that (i) it meets <u>one or more</u> of the grounds for designation specified in Part 1 of Schedule 1 to the BLR or (ii) <u>all</u> of the grounds specified in Part 2 of that Schedule. The specific information to be provided by the AI would depend on its actual circumstances. An AI seeking to “opt in” as a category 1 institution should discuss its intention with the HKMA before making formal application. • We will keep in view, and consider, the case for introducing a lower LCR requirement for general application to certain types of AI when there is an opportunity to review the BLR.

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13.	<p>5.2.12 With respect to the requirements set out in rule 27(2)(b) and rule 27(2)(c), a category 1 institution is not required to match currency composition of its HQLA with that of its total net cash outflows fully at all times. This recognizes the fact that a certain level of currency mismatch may arise in the normal course of banking operations. However, each category 1 institution should establish <u>internal targets</u> for its LCR in individual currencies having regard to the transferability of liquidity in different currencies. Any position exceeding an institution’s internal target should be reported to the institution’s senior management to ensure a prompt management review of the institution’s liquidity risk profile.....</p>	<ul style="list-style-type: none"> • We believe that AIs should be allowed to develop their own methodology for setting internal LCR targets for individual currencies based on the size and complexity of their business. We would like to seek the HKMA’s confirmation on the following methodologies which would be reasonable approaches to fulfilling this requirement: <ul style="list-style-type: none"> - Proportion of level one foreign currency denominated assets compared to the corresponding foreign currency total net cash outflows (without inflow caps) must be greater than a prescribed internal limit. This would be calculated in a similar manner to that described in paragraph 5.7.6 of LM-1; or - Proportion of adjusted HQLA compared to the adjusted net cash outflows as defined in Part 5 of MA(BS)23 – Return on Liquidity 	<ul style="list-style-type: none"> • It is indeed our intention for AIs to develop their own methodologies for setting internal limits for individual currencies. The two metrics cited by the Association appear to be in line with the underlying concepts within the LCR framework, although their adequacy for an AI to manage liquidity risk in individual currencies would depend on how such metrics are utilised by the AI and its actual circumstances. • The requirement set out in paragraph 5.2.12 (in respect of setting internal limits for LCR in different currencies) is a risk management measure for a category 1 institution to manage potential currency mismatch within the LCR framework. We expect each category 1 institution to meet this requirement in respect of those currencies in which it has liquidity needs, and there is no exception for LCR in USD. (Please also see paragraph 5.2.11, where it has been stated that the MA will have primary regard to a category 1 institution’s liquidity position in certain currencies, including USD.) • To avoid possible confusion with the setting of an internal LCR or LMR target as provided in paragraph 3.5.6, we propose revising paragraph 5.2.12 as follows: “... However, <u>it is generally expected that</u> each

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		<p>Monitoring Tools. Under this treatment, certain classes of HQLA will be subject to 15% and 40% ceilings and the net cash outflows will be subject to a 75% ceiling.</p> <ul style="list-style-type: none"> LM-1 requires that internal LCR targets should be set with reference to the transferability of liquidity in different currencies. We seek the HKMA’s confirmation that if an AI’s assessment is that there are no restrictions in the transferability of a currency (e.g. USD) then the requirement for internal LCR targets can be lifted. The Banking (Liquidity) Rules 27(2)(b) & (c) and BCBS publication on Basel III: The Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools (paragraph 17) requires banks to maintain a stock of HQLA with a composition that is consistent with the distribution of their liquidity needs by 	<p>category 1 institution should establish internal targets <u>limits</u> for its LCR in individual currencies, <u>and such limits should be set</u> having regard to <u>relevant factors such as</u> the transferability of liquidity in different currencies. Any position exceeding an institution’s <u>such</u> internal targets <u>limits</u> should be reported to the institution’s senior management to ensure a prompt management review of the institution’s liquidity risk profile.”</p>

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		<p>currency. Furthermore, where a currency mismatch exists, Alternative Liquidity Approach Option 2 allows AIs to address currency mismatches by applying a haircut on the foreign currency HQLA. As there is no specific mention of individual currency LCR targets in BCBS publications or the previous Hong Kong Banking Liquidity Rules, we would recommend removing these requirements. If these requirements are not removed, we request that the HKMA provide further clarification on the need for introducing these given the haircuts that will be applied to currency mismatches.</p>	
14.	<p><u>5.5.3</u> A category 1 institution that includes any level 2B assets in its HQLA must be particularly vigilant to the risks of holding such assets as a stock of liquidity. Appropriate systems and measures should be in place to support the institution’s monitoring and control over such risks. For example, an institution should</p>	<ul style="list-style-type: none"> • The current restrictions on the amount of level 2B assets to be included as HQLA is limited to: <ul style="list-style-type: none"> i. The aggregate of types of assets: <ul style="list-style-type: none"> (a) marketable debt securities with a minimum credit quality rating of 2, which are subject to a haircut of 50%, and 	<ul style="list-style-type: none"> • Paragraph 5.5.3 has been revised by removing “For example, an institution should establish specific limits on the holding of such assets, which should be tracked with regular management reports.”

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	<p>establish specific limits on the holding of such assets, which should be tracked with regular management reports.</p>	<p>(b) Residential mortgage backed securities which have been approved by the HKMA, subject to a haircut of 25%.</p> <p>ii. The total of the above cannot exceed 15% of the total HQLA.</p> <ul style="list-style-type: none"> We consider that it would be too restrictive to subject these level 2B assets to further internal thresholds. We recommend that the HKMA remove the requirement for additional internal thresholds. 	
15.	<p><u>5.8.20(c)(i) and footnote 60</u> In view of the diversity of business nature and customer profile across category 1 institutions, individual institutions may develop their own internal methodologies for determining the amount of operational deposits and excess operational deposits, in accordance with the following guiding principles:</p> <p>(i) The relevant system and methodology should be sufficient to facilitate ongoing assessment of the eligibility</p>	<ul style="list-style-type: none"> We acknowledge the need for regular reassessment of the nature of operational deposits given the range of customers that provide them. However, we consider that the need to perform assessments more frequently than once a month may not result in a more robust assessment. Instead, we would recommend that these institutions perform a monthly assessment and this is supplemented by ad hoc reassessments where certain triggers are met. These triggers may 	<ul style="list-style-type: none"> In the light of the Association’s comment, the relevant footnote has been revised as follows: <i>“... In general, such assessments should be conducted at least monthly, or more frequently where necessary.</i> For example, if a category 1 institution consistently reports a considerable amount of deposits as “operational deposits” (say, exceeding 5% of the institution’s total unweighted amount of expected cash outflows), there may be a case for the institution to conduct this type of assessment more frequently (say, more than once a month). <i>Category 1 institutions may, where appropriate, adopt other criteria (such as the contractual terms of operational</i>

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	<p>of deposits to be included by a category 1 institution as operational deposits. The frequency and level of sophistication of this type of assessment should be commensurate with the institution’s liquidity risk profile;⁶⁰.....</p> <p><u>Footnote 60</u></p> <p>For example, if category 1 institution consistently reports a considerable amount of deposits as "operational deposits" (say, exceeding 5% of the institution’s total unweighted amount of expected cash outflows), there may be a case for the institution to conduct this type of assessment more frequently (say, more than once a month). In any case, a category 1 institution should have adequate systems and procedures in place to cater for the possibility that it may be requested by the MA to conduct this type of assessment more frequently as and when necessary.</p>	<p>include situations where the contractual terms relating to a product have changed, a significant change to the customer profile has occurred, etc. These triggers would lead to a reassessment of the AI’s methodology and parameters.</p>	<p>services provided, customer profiles and anticipated changes of these factors) for triggering more frequent assessments. In any case, a category 1 institution should have adequate systems and procedures in place to cater for the possibility that it may be requested by the MA to conduct this type of assessment more frequently as and when necessary.”</p>

Annex 2

	Relevant extracts from the revised module LM-1	HKAB comment	HKMA response
16.	<p><u>5.8.25</u> Potential drawdown of undrawn committed facilities:</p> <p>To avoid doubt, a customer's drawdowns on any committed facilities or uncommitted facilities within the LCR period, if already approved by the institution, should be included in the calculation of expected cash outflows under clause 22 (instead of clause 21) of the code.</p>	<ul style="list-style-type: none"> We accept that the treatment of including approved potential drawdowns as part of the expected cash outflows in calculating the LCR. In case where the maturity date of such approved potential drawdowns also fall within the LCR period, we recommend that these expected cash inflows are also included in the LCR calculation. 	<ul style="list-style-type: none"> According to the Basel LCR standard (see paragraph 142), a bank should only include contractual inflows from <u>outstanding</u> exposures that are fully performing as cash inflows. This means anticipated repayment of loans that have not been drawn yet should not be included as inflows.
17.	<p><u>7.1.1</u> Under the Banking (Disclosure) Rules (BDR), an AI, unless otherwise exempted, must include in its interim financial statements and annual financial statements specified liquidity information in respect of its LCR or LMR as the case may require. The relevant requirements on disclosure of liquidity information are provided in the following sections of the BDR:</p> <p>(a) §30A – interim disclosure of LCR information by a locally incorporated category 1 institution;</p>	<ul style="list-style-type: none"> We believe that the annual disclosure of LMR information by a locally incorporated category 2 institution as described under sub-section (d) should reference §51B instead of §50B. 	<ul style="list-style-type: none"> We have revised paragraph 7.1.1 accordingly.

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	Relevant extracts from the revised module LM-1	HKAB comment	HKMA response
	<p>(b) §30B – interim disclosure of LMR information by a locally incorporated category 2 institution;</p> <p>(c) §51A – annual disclosure of LCR information by a locally incorporated category 1 institution;</p> <p>(d) §50B – annual disclosure of LMR information by a locally incorporated category 2 institution;.....</p>		
18.	<p>7.4.1 Each AI should have a formal disclosure policy to ensure compliance with the applicable statutory disclosure requirements.....</p> <p>7.4.2 The AI’s disclosure policy should be reviewed and approved periodically by its Board or a Board-level committee (such as the Audit Committee).⁷⁴</p> <p><u>Footnote 74</u></p> <p>Footnote 11 applies in the case of an AI incorporated outside Hong Kong</p>	<ul style="list-style-type: none"> • AIs are required to disclose information in relation to their approach to liquidity risk management under the Banking (Disclosure) Rules. In addition, section 7.2 of LM-1 provides further guidance on the type of information that AIs are encouraged to disclose. These types of additional disclosures will be assessed by the relevant control functions within the AI to determine the need for their disclosure. This will need to be considered based on the scale and complexity of the organization. • We consider that as each AI must 	<ul style="list-style-type: none"> • It should be noted that it is a legal requirement that an AI has in place a formal disclosure policy pursuant to section 5 of the Banking (Disclosure) Rules. • In the light of the Association’s comment, footnote 11 has been revised as follows to make it generally applicable throughout SPM module LM-1. (The original footnote 74 is therefore removed accordingly.) <p>“Unless specified otherwise, where there is a provision in this module to the effect that certain items should be reviewed or approved by the Board (or a Board-level committee) of an AI, it is acceptable, in the case of an AI incorporated outside Hong Kong, to have such review or approval by a designated function at the AI’s head office provided</p>

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	Relevant extracts from the revised module LM-1	HKAB comment	HKMA response
	<p><u>Footnote 11</u></p> <p>In the case of a category 1 institution which is incorporated outside Hong Kong, it is acceptable to have the internal LCR target for its Hong Kong branch reviewed and approved by a risk management function at its head office located outside Hong Kong.</p>	<p>comply with the above minimum requirements, there is no need for a formal disclosure policy. Accordingly, we recommend removing section 7.4.</p> <ul style="list-style-type: none"> • The wording in footnote 74 is unclear as the review by head office risk management functions may be interpreted as only being relevant to the internal LCR target (as mentioned in footnote 11) rather than covering the entire disclosure policy (in section 7.4). We request that the HKMA provide further clarification of this. 	<p>that such designation has been formally approved and documented by the AI’s Board.”</p>