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CALCULATION OF OPERATIONAL RISK

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## BANKING (CAPITAL) RULES

(Made by the Monetary Authority under section 98A of the Banking Ordinance (Cap. 155) as amended by the Banking (Amendment) Ordinance 2005 (19 of 2005) after consultation with the Financial Secretary, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, The Hong Kong Association of Banks and The DTC Association)

### PART 1

#### PRELIMINARY

#### 1. Commencement

These Rules shall come into operation on the day appointed for the commencement of section 4 of the Banking (Amendment) Ordinance 2005 (19 of 2005).

#### 2. Interpretation

- (1) In these Rules, unless the context otherwise requires—
- “alternative standardized approach” (替代標準計算法) means the method of calculating an authorized institution’s operational risk set out in Division 4 of Part 9;
- “ASA approach” (ASA 計算法) means the alternative standardized approach;
- “asset sale with recourse” (有追索權的資產出售), in relation to an authorized institution, means an asset sale transaction where the credit risk of the asset sold remains with the institution because the purchaser of the asset is entitled to sell the asset back to the institution within a specified period, or under specified circumstances, under the terms of the transaction;
- “back-testing” (回溯測試), in relation to the use of an internal model by an authorized institution, means a process whereby the daily changes in the value of a portfolio of exposures of the institution are compared with the daily VaR generated from the institution’s internal model applicable to that portfolio;
- “bank” (銀行) means—

- (a) an authorized institution except an authorized institution the authorization of which is for the time being suspended under section 24 or 25 of the Ordinance; or
- (b) a bank incorporated outside Hong Kong which is not an authorized institution except such a bank—
  - (i) which, in the opinion of the Monetary Authority, is not adequately supervised by the relevant banking supervisory authority; or
  - (ii) the licence or other authorization of which to carry on banking business is for the time being suspended;

“banking book” (銀行帳), in relation to an authorized institution, means all the institution’s on-balance sheet exposures and off-balance sheet exposures except such exposures which fall within the definition of “trading book” in this section;

“basic approach” (基本計算法) means the method of calculating an authorized institution’s credit risk for non-securitization exposures set out in Part 5;

“basic indicator approach” (基本指標計算法) means the method of calculating an authorized institution’s operational risk set out in Division 2 of Part 9;

“BIA approach” (BIA 計算法) means the basic indicator approach;

“bond” (債券) means an interest-bearing or zero-coupon debt security—

- (a) which is an acknowledgment of a debt promising payment of a specified sum to the holder of the debt security; and
- (b) which describes a time to maturity which is, or will become, definite;

“BSC approach” (BSC 計算法) means the basic approach;

“business day” (營業日), in relation to a country, means any day other than—

- (a) a public holiday in that country; or
- (b) a day on which the financial markets are not generally open for business in that country;

“calendar quarter” (季度) means a period of 3 consecutive calendar months ending on a calendar quarter end date;

“calendar quarter end date” (季度終結日) means the last day of March, June, September or December;

“capital charge” (資本要求), in relation to an authorized institution, means an amount of regulatory capital which the institution is required to hold for an exposure to a relevant risk which, if multiplied by 12.5, becomes the risk-weighted amount of that exposure for that risk;

“CCF” means a credit conversion factor;

“clean-up call” (結清權) has the meaning assigned to it by section 227(1);

“collective investment scheme” (集體投資計劃)—

- (a) subject to paragraph (b), has the meaning assigned to it by Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

- (b) does not include a restricted collective investment scheme;
- “collective provisions” (集體準備金), in relation to the exposures of an authorized institution, means an allowance for impairment loss arising from a collective assessment of the exposures for impairment loss;
- “commodity” (商品) means any precious metal (other than gold), base metal, non-precious metal, energy, agricultural asset or any other physical product which is traded on an exchange;
- “commodity-related derivative contract” (商品關聯衍生工具合約) has the meaning assigned to it by section 281;
- “comprehensive approach” (全面方法) has the meaning assigned to it by section 51;
- “confidence interval” (置信區間) means a statistical range with a specified probability that a given parameter lies within the range;
- “consolidated basis” (綜合基礎) has the meaning assigned to it by section 4;
- “consolidation group” (綜合集團) has the meaning assigned to it by section 4;
- “core capital” (核心資本) has the meaning assigned to it by section 35;
- “counter-guarantee” (反擔保), in relation to an authorized institution, means a guarantee (or other undertaking) given by one party for the payment of money by a guarantor upon the guarantor being required to make payment under the terms of a guarantee given by the guarantor to the institution in relation to the exposure of the institution to a third party;
- “country” (國家) includes—
- (a) subject to paragraph (b), any part of a country; and
  - (b) any jurisdiction except a restricted jurisdiction;
- “credit conversion factor” (信貸換算因數), in relation to an off-balance sheet exposure of an authorized institution, means a percentage by which the principal amount (within the meaning of section 51, 105, 139(1) or 227(1), as the case requires) of the exposure is multiplied as a part of the process for determining the credit equivalent amount (within the meaning of section 51, 105, 139(1) or 227(1), as the case requires) of the exposure;
- “credit default swap” (信用違責掉期) means a credit derivative contract under which the protection buyer pays a fee to the protection seller in return for a payment by the protection seller in the event of a default (or similar credit event) by a reference entity;
- “credit derivative contract” (信用衍生工具合約) means a forward contract, swap contract, option contract or similar derivative contract entered into by 2 parties with the intention to transfer credit risk in relation to a reference obligation from one party (“protection buyer”) to the other party (“protection seller”);
- “credit enhancement” (信用提升) has the meaning assigned to it by section 227(1);

- “credit event” (信用事件), in relation to a credit derivative contract, means an event specified in the contract which, if it occurs, obliges the protection seller to make a payment to the protection buyer;
- “credit-linked note” (信用掛鈎票據) means a form of structured note with an embedded credit default swap which allows the issuer of the note (“protection buyer”) to transfer credit risk to the buyer of the note (“protection seller”);
- “credit protection” (信用保障), in relation to an exposure of an authorized institution, means the protection afforded to the exposure by recognized credit risk mitigation;
- “credit protection provider” (信用保障提供者)—
- (a) in relation to a guarantee which constitutes credit protection, means the guarantor under the guarantee; or
  - (b) in relation to a credit derivative contract which constitutes credit protection, means the protection seller under the contract;
- “credit quality grade” (信用質素等級) means a grade represented by a numeral to which an ECAI rating is mapped for determining the appropriate risk-weight for an exposure of an authorized institution;
- “credit risk” (信用風險), in relation to an authorized institution, means the institution’s credit risk as referred to in paragraph (a) of the definition of “capital adequacy ratio” in section 2(1) of the Ordinance;
- “credit risk components” (信用風險組成部分) has the meaning assigned to it by section 139(1);
- “currency mismatch” (貨幣錯配), in relation to an exposure of an authorized institution—
- (a) subject to paragraph (b), means that the exposure and the credit protection afforded to the exposure are denominated in different currencies;
  - (b) does not include a case in which the institution has, in respect of the exposure, entered into a hedging agreement and, under that agreement, the risk of foreign exchange loss to the institution arising from the fact that the exposure and the credit protection afforded to the exposure are denominated in different currencies is eliminated;
- “current exposure” (現行風險承擔), in relation to an off-balance sheet exposure of an authorized institution which is an OTC derivative transaction (referred to in this definition as “existing transaction”) or credit derivative contract (referred to in this definition as “existing contract”), means the replacement cost—
- (a) which would be incurred by the institution if it were required to enter into another OTC derivative transaction or credit derivative contract, as the case may be, to replace the existing transaction or existing contract, as the case may be, with another

counterparty with substantially the same economic consequences for the institution; and

- (b) which is calculated by marking-to-market the existing transaction or existing contract, as the case may be, and—
- (i) if the resultant value is positive for the institution, taking the resultant value of the existing transaction or existing contract, as the case may be;
  - (ii) if the resultant value is negative for the institution, taking the resultant value of the existing transaction or existing contract, as the case may be, as zero;

“debt-related derivative contract” (債務關聯衍生工具合約) has the meaning assigned to it by section 281;

“debt security contract” (債務證券合約) means 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, one or more than one underlying debt security or underlying debt security index (being an index calculated by reference to a basket of debt securities);

“delivery-versus-payment basis” (貨銀對付形式), in relation to a transaction, means the delivery of a thing under the transaction and the payment for the thing occur simultaneously;

“derivative contract” (衍生工具合約)—

- (a) means a financial instrument (other than a bond, loan, share, note or structured financial instrument) the value of which is determined by reference to the value of, or any fluctuation in the value of, one or more than one underlying asset, index, financial instrument, rate or thing as designated in the financial instrument;
- (b) where a financial instrument which falls within paragraph (a) is embedded in or combined with, or forms part of, a bond, loan, share, note or structured financial instrument, means only the financial instrument which falls within paragraph (a);

“dilution risk” (攤薄風險) has the meaning assigned to it by section 139(1);

“direct credit substitute” (直接信貸替代項目), in relation to an authorized institution—

- (a) means an irrevocable off-balance sheet exposure of the institution which carries the same credit risk to the institution as a direct extension of credit by the institution; and
- (b) includes—
  - (i) guarantees given by the institution;
  - (ii) standby letters of credit serving as financial guarantees for loans;
  - (iii) acceptances; and



- (iv) financial liabilities arising from the selling of credit protection under credit derivative contracts in the form of total return swaps or credit default swaps booked in the institution's banking book;

“domestic currency exposure” (本地貨幣風險承擔) means an exposure of an authorized institution which is—

- (a) denominated in the local currency of the obligor in respect of the exposure; and
- (b) funded by liabilities entered into by the institution in that currency;

“domestic public sector entity” (本地公營單位) means an entity specified in Part 1 of Schedule 1;

“EAD” has the meaning assigned to it by section 139(1);

“early amortization provision” (提早攤銷規定) has the meaning assigned to it by section 227(1);

“ECAI” means an external credit assessment institution;

“ECAI issue specific rating” (ECAI 特定債項評級), in relation to an exposure, subject to subsection (7), means—

- (a) in section 55, a long-term credit assessment rating—
  - (i) which is assigned to the exposure by an ECAI; and
  - (ii) which is for the time being neither withdrawn nor suspended by that ECAI;
- (b) in sections 59, 60 and 61 and Parts 7 and 8, a short-term credit assessment rating or long-term credit assessment rating—
  - (i) which is assigned to the exposure by an ECAI; and
  - (ii) which is for the time being neither withdrawn nor suspended by that ECAI; or
- (c) in the case of a holding of units or shares in a collective investment scheme which only holds cash or fixed income assets, a credit assessment rating—
  - (i) which is assigned to the scheme by an ECAI based on the credit quality of the cash held or the fixed income assets held, as the case may be; and
  - (ii) which is for the time being neither withdrawn nor suspended by that ECAI;

“ECAI issuer rating” (ECAI 發債人評級), in relation to any person (however described), means a long-term credit assessment rating—

- (a) which is assigned to the person by an ECAI; and
- (b) which is for the time being neither withdrawn nor suspended by that ECAI;

“ECAI rating” (ECAI 評級) means—

- (a) an ECAI issuer rating; or
- (b) an ECAI issue specific rating;

“EL amount” (EL 額) has the meaning assigned to it by section 139(1);

“equity contract” (股權合約) means 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, one or more than one underlying equity or underlying equity index (being an index calculated by reference to a basket of equities);

“equity-related derivative contract” (股權關聯衍生工具合約) has the meaning assigned to it by section 281;

“exception” (例外情況), in relation to back-testing by an authorized institution, means an instance in which the daily losses in the value of a portfolio of exposures of the institution are above the daily VaR generated from the institution’s internal model applicable to that portfolio;

“excess spread” (超額利差) has the meaning assigned to it by section 227(1);

“exchange controls” (外匯管制) means controls or restrictions imposed by the government of a country on the exchange of the currency of that country for the currency of another country;

“exchange rate contract” (匯率合約)—

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

(b) includes 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;

“external credit assessment institution” (外部信用評估機構) means—

(a) Standard & Poor’s Ratings Services;

(b) Moody’s Investors Service;

(c) Fitch Ratings; or

(d) Rating and Investment Information, Inc.;

“facility grade” (融通等級) has the meaning assigned to it by section 139(1);

“fair value” (公平價值)—

(a) in relation to an asset, means the amount for which the asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction; or

(b) in relation to a liability, means the amount for which the liability could be settled between knowledgeable, willing parties in an arm’s length transaction;

“financial instrument” (金融工具) includes a financial instrument in the form of—

(a) a written document;

(b) information which is recorded in the form of any entry in a book of account;

- (c) information which is recorded (whether by means of a computer or otherwise) in a non-legible form but is capable of being reproduced in a legible form; and
- (d) any combination of the document and information referred to in paragraphs (a), (b) and (c);

“first-to-default credit derivative contract” (首先違責者信用衍生工具合約) means a credit derivative contract under which—

- (a) the protection buyer obtains credit protection for a basket of exposures held by it; and
- (b) the first default among the obligations specified in the contract for the purposes of determining whether a credit event has occurred triggers the credit protection and terminates the contract;

“Fitch Ratings” (惠譽評級) means that organization the membership of which—

- (a) consists of—
  - (i) members of the group of companies of which Fitch, Inc. is the ultimate holding company;
  - (ii) Fitch Ratings Lanka Limited; and
  - (iii) Fitch Ratings (Thailand) Limited;
- (b) adheres to a common set of core methodologies, practices and procedures for issuing credit assessment ratings; and
- (c) issues credit assessment ratings under the name of Fitch Ratings;

“foreign public sector entity” (非本地公營單位) means an entity specified by a relevant banking supervisory authority outside Hong Kong (whether by means of legislation or a public notice or otherwise) to be a public sector entity for the purposes of applying preferential risk-weighting treatment under capital adequacy standards formulated in accordance with—

- (a) the document entitled “International Convergence of Capital Measurement and Capital Standards” published by the Basel Committee on Banking Supervision in July 1988; or
- (b) the document entitled “International Convergence of Capital Measurement and Capital Standards — A Revised Framework (Comprehensive Version)” published by the Basel Committee on Banking Supervision in June 2006;

“forward asset purchase” (遠期資產購買), in relation to an authorized institution—

- (a) subject to paragraph (b), means a contractually binding commitment by the institution to purchase on a specified future date, and according to specified terms, a loan, security or other asset from another party, and includes a contractually binding commitment under a put option written by the institution;



- (b) does not include a contractually binding commitment arising from a forward foreign exchange contract;
- “forward contract” (遠期合約)—
- (a) subject to paragraph (b), means a contract between two parties for the purchase or sale of a specified quantity of a specified commodity, currency, financial instrument or thing at a specified price on a specified future date;
- (b) does not include a futures contract;
- “forward deposits placed” (遠期有期存款), in relation to an authorized institution, means an agreement between the institution and another party whereby the institution will place a deposit at a specified rate of interest with the party on a specified future date;
- “foundation IRB approach” (基礎 IRB 計算法) has the meaning assigned to it by section 139(1);
- “futures contract” (期貨合約) means a contract which is made under the rules or conventions of a futures exchange and traded on the exchange;
- “gain-on-sale” (出售收益) has the meaning assigned to it by section 227(1);
- “general market risk” (一般市場風險) has the meaning assigned to it by section 281;
- “gross income” (總收入) has the meaning assigned to it by section 323;
- “group of companies” (公司集團) has the meaning assigned to it by section 2(1) of the Companies Ordinance (Cap. 32);
- “guarantee” (擔保) includes an indemnity;
- “haircut” (扣減), in relation to an authorized institution, means an adjustment to be applied to the credit protection held by the institution, or the institution’s exposure, to take into account possible future price fluctuations or fluctuations in exchange rates;
- “IMM approach” (IMM 計算法) means the internal models approach;
- “impairment loss” (減值損失), in relation to an exposure of an authorized institution, means the amount by which the carrying amount of the exposure exceeds the exposure’s recoverable amount;
- “incorporated” (成立為法團) includes established;
- “insurance firm” (保險商號)—
- (a) means an entity—
- (i) which is authorized and supervised by an insurance regulator pursuant to the law of a country other than Hong Kong; and
- (ii) which is subject to supervisory arrangements regarding the maintenance of adequate capital to support its business activities comparable to those prescribed for authorized institutions under the Ordinance and these Rules; and
- (b) includes an authorized insurer within the meaning of the Insurance Companies Ordinance (Cap. 41);

- “insurance regulator” (保險規管當局) does not include a restricted insurance regulator;
- “interest rate contract” (利率合約) means a single-currency forward rate contract, interest rate swap contract, interest rate option contract or similar derivative contract;
- “interest rate derivative contract” (利率衍生工具合約) has the meaning assigned to it by section 281;
- “internal capital” (內部資本), in relation to an authorized institution, means the amount of capital which the institution holds and allocates internally as a result of the institution’s assessment of the risks faced by the institution;
- “internal model” (內部模式) means a model used by an authorized institution to measure the institution’s credit risk, market risk or operational risk;
- “internal models approach” (內部模式計算法) means the method of calculating an authorized institution’s market risk set out in Divisions 11 and 12 of Part 8;
- “internal ratings-based approach” (內部評級基準計算法) means the method of calculating an authorized institution’s credit risk for non-securitization exposures set out in Part 6;
- “internal ratings-based (securitization) approach” (內部評級基準(證券化)計算法) means the method of calculating an authorized institution’s credit risk for securitization exposures set out in Divisions 4, 5 and 6 of Part 7;
- “IRB approach” (IRB 計算法) means the internal ratings-based approach;
- “IRB class” (IRB 類別) has the meaning assigned to it by section 139(1);
- “IRB coverage ratio” (IRB 涵蓋比率) has the meaning assigned to it by section 4;
- “IRB(S) approach” (IRB(S) 計算法) means the internal ratings-based (securitization) approach;
- “IRB subclass” (IRB 子類別) has the meaning assigned to it by section 139(1);
- “last 3 years” (最近 3 個年度) has the meaning assigned to it by section 323;
- “LGD” has the meaning assigned to it by section 139(1);
- “liquidity facility” (流動資金融通) has the meaning assigned to it by section 227(1);
- “local currency” (本地貨幣), in relation to a country, means the currency issued by the central government, the central bank, the monetary authority, or an authorized note-issuing bank, of that country;
- “long-term ECAI issue specific rating” (長期 ECAI 特定債項評級), in relation to an exposure, means an ECAI issue specific rating for the exposure which is a long-term credit assessment rating;
- “main index” (主要指數) has the meaning assigned to it by section 51;
- “market risk” (市場風險), in relation to an authorized institution, means the institution’s market risk as referred to in paragraph (b) of the definition of “capital adequacy ratio” in section 2(1) of the Ordinance;

“market risk capital charge” (市場風險資本要求) has the meaning assigned to it by section 281;

“mark-to-market” (按市價計值), in relation to any transaction, position, exposure or contract, means to revalue the transaction, position, exposure or contract, as the case may be, at current market price;

“minimum holding period” (最短持有期), in relation to the use of the STC approach, has the meaning assigned to it by section 51;

“Moody’s Investors Service” (穆迪投資者服務) means that organization the membership of which—

- (a) consists of members of the group of companies of which Moody’s Corporation is the ultimate holding company;
- (b) adheres to a common set of core methodologies, practices and procedures for issuing credit assessment ratings; and
- (c) issues credit assessment ratings under the name of Moody’s Investors Service;

“net book value” (淨帳面價值), in relation to any thing, means the thing’s book value after deducting the amount of any allowance for impairment loss arising from an individual assessment of the thing for impairment loss;

“nettable” (可作淨額計算的), in relation to an exposure (however described) of an authorized institution, means that the exposure is subject to a valid bilateral netting agreement;

“non-securitization exposure” (非證券化類別風險承擔), in relation to an authorized institution, means an exposure of the institution which is not a securitization exposure;

“note issuance and revolving underwriting facilities” (票據發行及循環式包銷融通) means any facility in respect of the issue of debt securities to the market where—

- (a) an issuer may draw down funds, up to a specified limit, over a specified period, should any issue of the debt securities prove unable to be placed in the market; and
- (b) the unplaced amount is to be taken up, or funds are to be made available, by the underwriter of the facility;

“notional amount” (名義數額), in relation to an off-balance sheet exposure of an authorized institution, means the reference amount used to calculate payment obligation between the parties to the exposure;

“obligor” (承擔義務人)—

- (a) in relation to an exposure of an authorized institution in respect of a guarantee, means the guarantor under the guarantee;
- (b) in relation to an exposure of an authorized institution in respect of a credit derivative contract, means the protection seller under the contract; or
- (c) in relation to any other exposure of an authorized institution, means a person—

- (i) to whom the institution has an exposure; and
- (ii) who has the primary obligation to repay, pay or otherwise settle the exposure;

“obligor grade” (承擔義務人等級) has the meaning assigned to it by section 139(1);

“operational risk” (業務操作風險), in relation to an authorized institution, means the institution’s operational risk as referred to in paragraph (c) of the definition of “capital adequacy ratio” in section 2(1) of the Ordinance;

“option contract” (期權合約) means a contract which gives the holder of the contract the option or right, exercisable at or before a specified time, to purchase or sell a specified quantity of a specified commodity, currency, financial instrument or thing at a specified price;

“originating institution” (發起機構) has the meaning assigned to it by section 227(1);

“OTC derivative transaction” means an over-the-counter derivative transaction;

“other commodity contract” (其他商品合約) means 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, one or more than one underlying commodity other than precious metal or underlying commodity index (being an index calculated by reference to a basket of commodities other than precious metal);

“over-the-counter derivative transaction” (場外衍生工具交易)—

(a) subject to paragraph (b), means a derivative contract other than a credit derivative contract;

(b) does not include a contract referred to in paragraph (a)—

(i) which is traded on an exchange; and

(ii) which is subject to daily re-margining requirements;

“parent bank” (母銀行), in relation to an authorized institution, means any holding company of the institution which is authorized as a bank in the overseas country in which the holding company is incorporated;

“partly paid-up shares and securities” (部分付款股份及證券), in relation to an authorized institution, means shares or securities the unpaid portion of which the institution may be called upon by the issuer to pay on a specified or unspecified date in the future;

“past due exposure” (逾期風險承擔), in relation to the use of the STC approach, has the meaning assigned to it by section 51;

“PD” has the meaning assigned to it by section 139(1);

“PD/LGD approach” (PD/LGD 計算法) has the meaning assigned to it by section 139(1);

“pool” (組別), in relation to an authorized institution which uses the IRB approach, has the meaning assigned to it by section 139(1);

“position” (持倉), in relation to an authorized institution’s calculation of market risk, has the meaning assigned to it by section 281;

“positive current exposure” (現行風險承擔正數), in relation to a transaction of an authorized institution referred to in paragraph (i) or (j) of the definition of “cash items” in section 51 or 105 or referred to in paragraph (h) or (i) of the definition of “cash items” in section 139(1), means the risk of loss to the institution on the difference between—

- (a) the transaction valued at the agreed settlement price; and
- (b) the transaction valued at the current market price;

“potential exposure” (潛在風險承擔), in relation to an off-balance sheet exposure of an authorized institution which is an OTC derivative transaction or a credit derivative contract, means the principal amount (within the meaning of section 51, 105, 139(1) or 227(1), as the case requires) of the transaction or contract, as the case may be, multiplied by the applicable CCF;

“precious metal contract” (貴金屬合約) means 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, one or more than one underlying precious metal other than gold or underlying precious metal index (being an index calculated by reference to a basket of precious metals other than gold);

“prior consent” (事先同意) means prior consent in writing;

“property-holding shell company” (持物業空殼公司) means a company which does not engage in any business activity except for the sole purpose of the buying, holding and selling of residential properties;

“public sector entity” (公營單位) means—

- (a) a domestic public sector entity; or
- (b) a foreign public sector entity;

“rated” (獲評級), in relation to a securitization exposure, has the meaning assigned to it by section 227(1);

“ratings-based method” (評級基準方法) has the meaning assigned to it by section 227(1);

“rating system” (評級系統) has the meaning assigned to it by section 139(1);

“recognized credit risk mitigation” (認可減低信用風險措施), in relation to an exposure of an authorized institution, means the use by the institution of—

- (a) recognized netting;
- (b) recognized collateral (within the meaning of section 51, 105 or 139(1), as the case requires);
- (c) a recognized guarantee (within the meaning of section 51, 105 or 139(1), as the case requires); or
- (d) a recognized credit derivative contract (within the meaning of section 51, 105 or 139(1), as the case requires),



for the purposes of reducing the risk-weighted amount of the exposure pursuant to these Rules;

“recognized exchange” (認可交易所) means—

- (a) a recognized stock exchange; or
- (b) a recognized futures exchange;

“recognized futures exchange” (認可期貨交易所) means a futures exchange specified in Part 2 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

“recognized netting” (認可淨額計算) means any netting done pursuant to a valid bilateral netting agreement;

“recognized stock exchange” (認可證券交易所) means a stock exchange specified in Part 3 of Schedule 1 to the Securities and Futures Ordinance (Cap. 571);

“reference entity” (參照實體), in relation to a credit derivative contract, means the entity on whose credit status that contract is based;

“reference obligation” (參照義務), in relation to a credit derivative contract, means the specified obligation of a specified reference entity in the contract, pursuant to which the basis for the settlement of the contract is determined;

“regulatory capital” (監管資本), in relation to an authorized institution, means the amount of capital the institution is required to hold in accordance with the Ordinance and these Rules in respect of its risk-weighted amount for each relevant risk;

“regulatory capital arbitrage” (監管資本套戥) has the meaning assigned to it by section 4;

“relevant international organization” (有關國際組織) means an international organization specified in Part 10 of Schedule 1;

“relevant risk” (有關風險), in relation to an authorized institution, means the credit risk, market risk or operational risk of the institution;

“repo-style transaction” (回購形式交易), in relation to an authorized institution, means a transaction entered into by the institution whereby the institution—

- (a) agrees to sell securities to a counterparty for a sum of money with a commitment to repurchase the securities at a specified price on a specified future date from the counterparty;
- (b) lends securities to a counterparty and receives a sum of money or other securities from the counterparty in exchange as collateral;
- (c) agrees to acquire securities from a counterparty for a sum of money with a commitment to resell the securities at a specified price on a specified future date to the counterparty; or
- (d) borrows securities from a counterparty and provides a sum of money or other securities to the counterparty in exchange as collateral;

“residential mortgage loan” (住宅按揭貸款), in relation to an authorized institution, means a credit facility provided by the institution to a borrower—

(a) which is secured on a residential property or residential properties; and

(b) which is required by the facility agreement between the institution and the borrower to be secured on the residential property or residential properties referred to in paragraph (a);

“restricted collective investment scheme” (受限制集體投資計劃) means a collective investment scheme specified in Part 3 of Schedule 1;

“restricted debt securities” (受限制債務證券) means debt securities specified in Part 4 of Schedule 1;

“restricted foreign public sector entity” (受限制非本地公營單位) means a foreign public sector entity specified in Part 5 of Schedule 1;

“restricted insurance regulator” (受限制保險規管當局) means an insurance regulator specified in Part 6 of Schedule 1;

“restricted jurisdiction” (受限制司法管轄區) means a jurisdiction specified in Part 7 of Schedule 1;

“restricted securities regulator” (受限制證券規管當局) means a securities regulator specified in Part 8 of Schedule 1;

“restricted sovereign” (受限制官方實體) means a sovereign specified in Part 9 of Schedule 1;

“risk category” (風險類別), in relation to an authorized institution’s calculation of market risk, has the meaning assigned to it by section 281;

“risk-weighted amount” (風險加權數額)—

(a) in relation to the calculation of the credit risk of a non-securitization exposure of an authorized institution, means the amount of the institution’s exposure to credit risk calculated in accordance with Part 4, 5 or 6, as the case requires;

(b) in relation to the calculation of the credit risk of a securitization exposure of an authorized institution, means the amount of the institution’s exposure to credit risk calculated in accordance with Part 7;

(c) in relation to the calculation of the market risk of an authorized institution, means the amount of the institution’s exposure to market risk calculated in accordance with Part 8;

(d) in relation to the calculation of the operational risk of an authorized institution, means the amount of the institution’s exposure to operational risk calculated in accordance with Part 9;

“risk-weighted amount for credit risk” (信用風險的風險加權數額), in relation to an authorized institution, means the total risk-weighted amount of—

- (a) the institution's non-securitization exposures to credit risk calculated in accordance with Part 4, 5 or 6, as the case requires; and
- (b) the institution's securitization exposures to credit risk calculated in accordance with Part 7;

“risk-weighted amount for market risk” (市場風險的風險加權數額), in relation to an authorized institution, means the total risk-weighted amount of the institution's exposures to market risk calculated in accordance with Part 8;

“risk-weighted amount for operational risk” (業務操作風險的風險加權數額), in relation to an authorized institution, means the risk-weighted amount of the institution's exposure to operational risk calculated in accordance with Part 9;

“second-to-default credit derivative contract” (第二違責者信用衍生工具合約) means a credit derivative contract under which—

- (a) the protection buyer obtains credit protection for a basket of exposures held by it; and
- (b) the second default among the obligations specified in the contract for the purposes of determining whether a credit event has occurred triggers the credit protection and terminates the contract;

“section 79A(1) requirement” (第 79A(1) 條規定), in relation to an authorized institution, means a requirement in a notice under section 79A(1) of the Ordinance whereby a provision of Part XV of the Ordinance is to apply to the institution on—

- (a) a consolidated basis in respect of all the subsidiaries of the institution;
- (b) a consolidated basis in respect of such subsidiaries of the institution as specified in the notice;
- (c) the consolidated basis referred to in paragraph (a) and an unconsolidated basis unless otherwise specified in the notice; or
- (d) the consolidated basis referred to in paragraph (b) and an unconsolidated basis unless otherwise specified in the notice;

“section 98(2) requirement” (第 98(2) 條規定), in relation to an authorized institution, means a requirement in a notice under section 98(2) of the Ordinance whereby the capital adequacy ratio of the institution is to be calculated on—

- (a) a consolidated basis in respect of all the subsidiaries of the institution;
- (b) a consolidated basis in respect of such subsidiaries of the institution as specified in the notice;
- (c) the consolidated basis referred to in paragraph (a) and an unconsolidated basis unless otherwise specified in the notice; or



- (d) the consolidated basis referred to in paragraph (b) and an unconsolidated basis unless otherwise specified in the notice;
- “securities firm” (證券商號)—
- (a) means an entity (other than a bank)—
- (i) which is authorized and supervised by a securities regulator pursuant to the law of a country other than Hong Kong; and
- (ii) which is subject to supervisory arrangements regarding the maintenance of adequate capital to support its business activities comparable to those prescribed for authorized institutions under the Ordinance and these Rules; and
- (b) includes a licensed corporation which has been granted a licence to carry on a regulated activity by the Securities and Futures Commission of Hong Kong;
- “securities regulator” (證券規管當局) does not include a restricted securities regulator;
- “securitization exposure” (證券化類別風險承擔) has the meaning assigned to it by section 227(1);
- “securitization issues” (證券化票據) has the meaning assigned to it by section 227(1);
- “securitization transaction” (證券化交易) has the meaning assigned to it by section 227(1);
- “senior management” (高級管理人員), in relation to an authorized institution, includes the chief executives and managers of the institution;
- “servicer cash advance facility” (服務者現金墊支融通) has the meaning assigned to it by section 227(1);
- “short-term ECAI issue specific rating” (短期 ECAI 特定債項評級), in relation to an exposure, means an ECAI issue specific rating for the exposure which is a short-term credit assessment rating;
- “solo basis” (單獨基礎) has the meaning assigned to it by section 4;
- “solo-consolidated basis” (單獨 — 綜合基礎) has the meaning assigned to it by section 4;
- “solo-consolidated subsidiary” (單獨 — 綜合附屬公司) has the meaning assigned to it by section 4;
- “sovereign” (官方實體) means—
- (a) the Government;
- (b) the central government of a country;
- (c) the central bank of a country;
- (d) an authority of a country which performs in the country functions similar to the functions performed by the Monetary Authority; or
- (e) a relevant international organization;

“sovereign foreign public sector entity” (屬官方實體的非本地公營單位) has the meaning assigned to it by section 51;

“SPE” has the meaning assigned to it by section 227(1);

“specific provisions” (特定準備金), in relation to an exposure of an authorized institution, means an allowance for impairment loss of that exposure which is individually assessed for impairment loss;

“specific risk” (特定風險) has the meaning assigned to it by section 281;

“Standard & Poor’s Ratings Services” (標準普爾評級服務) means that organization the membership of which—

(a) consists of business units within members of the group of companies of which The McGraw-Hill Companies, Inc. is the ultimate holding company;

(b) adheres to a common set of core methodologies, practices and procedures for issuing credit assessment ratings; and

(c) issues credit assessment ratings under the name of Standard & Poor’s Ratings Services;

“standard supervisory haircut” (標準監管扣減) has the meaning assigned to it by section 51;

“standardized business line” (標準業務線) has the meaning assigned to it by section 323;

“standardized (credit risk) approach” (標準(信用風險)計算法) means the method of calculating an authorized institution’s credit risk for non-securitization exposures set out in Part 4;

“standardized (market risk) approach” (標準(市場風險)計算法) means the method of calculating an authorized institution’s market risk set out in Divisions 2 to 10 of Part 8;

“standardized (operational risk) approach” (標準(業務操作風險)計算法) means the method of calculating an authorized institution’s operational risk set out in Division 3 of Part 9;

“standardized (securitization) approach” (標準(證券化)計算法) means the method of calculating an authorized institution’s credit risk for securitization exposures set out in Division 3 of Part 7;

“STC approach” (STC 計算法) means the standardized (credit risk) approach;

“STC(S) approach” (STC(S) 計算法) means the standardized (securitization) approach;

“STM approach” (STM 計算法) means the standardized (market risk) approach;

“STO approach” (STO 計算法) means the standardized (operational risk) approach;

“stress-testing” (壓力測試), in relation to an authorized institution, means the use by the institution of a risk management technique to evaluate the potential impact on the institution of a specific event, or movements in

- a set of financial variables, or both, under market conditions depicting various levels of market movement and financial distress;
- “supervisory formula method” (監管公式方法) has the meaning assigned to it by section 227(1);
- “supplementary capital” (附加資本) has the meaning assigned to it by section 35;
- “swap contract” (掉期合約) means a contract under which two parties agree to exchange assets, liabilities or cash flows according to specified terms over a specified period;
- “synthetic securitization transaction” (合成證券化交易) has the meaning assigned to it by section 227(1);
- “title transfer” (所有權轉移), in relation to collateral, means an outright transfer of the legal and beneficial ownership in the collateral from the collateral provider to the collateral taker;
- “total EL amount” (EL 總額) has the meaning assigned to it by section 139(1);
- “total eligible provisions” (合資格準備金總額) has the meaning assigned to it by section 139(1);
- “total return swap” (總回報掉期) means a credit derivative contract under which the protection buyer—
- (a) agrees to pay the protection seller all cash flows which arise from a reference obligation together with any appreciation in the market value of the reference obligation; and
  - (b) receives, in return for that agreement, a spread over a specified index together with any depreciation in the value of the reference obligation during the term of the contract;
- “trade-related contingency” (貿易關聯或有項目)—
- (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;
- “trading book” (交易帳), in relation to an authorized institution, means the institution’s exposures in financial instruments and commodities where—
- (a) the financial instruments and commodities are held—
    - (i) with the intention of trading; or
    - (ii) for the purposes of hedging one or more of the exposures in other financial instruments and commodities which are held with the intention of trading;
  - (b) the financial instruments are free of any restrictive covenants on tradability, or the exposures in the financial instruments and commodities are able to be completely hedged; and
  - (c) the exposures are frequently and accurately valued and actively managed;

“trading day” (交易日) means a day on which a financial market is open for trading;

“traditional securitization transaction” (傳統證券化交易) has the meaning assigned to it by section 227(1);

“transaction-related contingency” (交易關聯或有項目), in relation to an authorized institution—

(a) means a contingent liability which involves an irrevocable obligation of the institution to pay a beneficiary when a customer fails to perform a contractual and non-financial obligation; and

(b) includes a performance bond, bid bond, warranty and standby letter of credit related to a particular transaction;

“transitional period” (過渡期) has the meaning assigned to it by section 4;

“underlying exposures” (組成項目), in relation to a securitization transaction, has the meaning assigned to it by section 227(1);

“unrated” (無評級), in relation to a securitization exposure, has the meaning assigned to it by section 227(1);

“valid bilateral netting agreement” (有效雙邊淨額結算協議), in relation to an authorized institution, means an agreement in respect of which the following conditions are satisfied—

(a) the agreement is in writing;

(b) the agreement creates a single legal obligation for all individual contracts covered by the agreement, and provides, in effect, that the institution would have a single claim or obligation to receive or pay only the net amount of the sum of the positive and negative mark-to-market values of the individual contracts covered by the agreement in the event that a counterparty to the agreement, or a counterparty to whom the agreement has been validly assigned, fails to comply with any obligation under the agreement due to default, insolvency, bankruptcy, or similar circumstance;

(c) the institution has been given legal advice in writing to the effect that in the event of a challenge in a court of law, including a challenge resulting from default, insolvency, bankruptcy, or similar circumstance, the relevant court or administrative authority would find the institution’s exposure to be the net amount under—

(i) the law of the jurisdiction in which the counterparty is incorporated or the equivalent location in the case of non-corporate entities, and if a branch of the counterparty is involved, then also under the law of the jurisdiction in which the branch is located;

- (ii) the law which governs the individual contracts covered by the agreement; and
- (iii) the law which governs the agreement;
- (d) the institution establishes and maintains procedures to monitor developments in any law relevant to the agreement and to ensure that the agreement continues to satisfy this definition;
- (e) the institution manages the transactions covered by the agreement on a net basis;
- (f) the institution maintains in its files documentation adequate to support the netting of the contracts covered by the agreement; and
- (g) the agreement is not subject to a provision that permits the non-defaulting counterparty to make only limited payment, or no payment at all, to the defaulter or the estate of the defaulter, regardless of whether or not the defaulter is a net creditor under the agreement;

“value-at-risk” (風險值), in relation to a portfolio of exposures, means a measure of the worst expected loss on the portfolio resulting from market movement over a period of time within a given confidence interval;

“VaR” means value-at-risk.

(2) A reference in these Rules to a table or formula followed by a number is a reference to the table or formula, as the case may be, in these Rules bearing that number.

(3) Where, under a provision of these Rules, the prior consent of the Monetary Authority is required by an authorized institution in respect of any matter, the institution shall seek the prior consent by making an application in the specified form, if any, to the Monetary Authority.

(4) Where, under a provision of these Rules, the Monetary Authority is required to give notice of any matter to all authorized institutions incorporated in Hong Kong, or to a class of such institutions, it is sufficient compliance with that provision if the Monetary Authority publishes the notice in the Gazette.

(5) Where any matter specified in a section of these Rules is qualified by the word “appropriate”, “material” or “relevant”, then, for the purposes of assisting in ascertaining the nature of that qualification insofar as it relates to that matter, regard shall be had to the guidelines, if any, issued under the Ordinance which are applicable to that section.

(6) A reference in these Rules to an exposure of an authorized institution to a guarantor arising in respect of a guarantee, or to a counterparty arising in respect of a credit derivative contract purchased by the institution, is an exposure for the purposes of these Rules whether or not any event has occurred which may give rise to a right to sue, or a claim on, the guarantor or the counterparty, as the case may be.



(7) For the purposes of these Rules, an authorized institution shall not use an ECAI issue specific rating allocated to a debt obligation of a person which has ceased to be outstanding for the purposes of determining the risk-weight to be applied to another debt obligation of that person.

### 3. Calculation of capital adequacy ratio

For the purposes of these Rules as read with the Ordinance, the capital adequacy ratio of an authorized institution shall be calculated, subject to sections 29, 30 and 31, as the ratio, expressed as a percentage, of the institution's capital base as determined in accordance with Part 3, to the sum of—

- (a) the institution's risk-weighted amount for credit risk;
- (b) the institution's risk-weighted amount for market risk; and
- (c) the institution's risk-weighted amount for operational risk.

## PART 2

### PRESCRIBED APPROACHES IN RELATION TO CALCULATION OF CAPITAL ADEQUACY RATIO

#### Division 1—General

### 4. Interpretation of Part 2

In this Part, unless the context otherwise requires—

“consolidated basis” (綜合基礎), in relation to the calculation of an authorized institution's capital adequacy ratio, means the basis set out in section 31 on which the institution calculates that ratio;

“consolidation group” (綜合集團), in relation to an authorized institution, means—

- (a) the institution; and
- (b) such subsidiaries of the institution as specified in a section 98(2) requirement given to the institution;

“IRB coverage ratio” (IRB 涵蓋比率), in relation to an authorized institution which uses the IRB approach, means the ratio, expressed as a percentage, of the sum of the following risk-weighted amounts to the institution's risk-weighted amount for credit risk—

- (a) the risk-weighted amount for credit risk of the institution's non-securitization exposures calculated under the IRB approach; and
- (b) the risk-weighted amount for credit risk of the institution's securitization exposures calculated under the IRB(S) approach;

- “regulatory capital arbitrage” (監管資本套戩), in relation to an authorized institution, means the use by the institution of a combination of different calculation approaches or methods in respect of the institution’s exposures with the intention of minimizing its regulatory capital by selectively choosing a given calculation approach or method for certain exposures predominantly to achieve a lower regulatory capital;
- “solo basis” (單獨基礎), in relation to the calculation of an authorized institution’s capital adequacy ratio, means the basis set out in section 29 on which the institution calculates that ratio;
- “solo-consolidated basis” (單獨 — 綜合基礎), in relation to the calculation of an authorized institution’s capital adequacy ratio, means the basis set out in section 30 on which the institution calculates that ratio;
- “solo-consolidated subsidiary” (單獨 — 綜合附屬公司), in relation to an authorized institution, means a subsidiary of the institution specified in an approval granted to the institution under section 28(2)(a);
- “transitional period” (過渡期) means the period from 1 January 2007 to 31 December 2009, both days inclusive.

#### **Division 2—Prescribed approaches to calculation of credit risk for non-securitization exposures**

##### **5. Authorized institution shall only use STC approach, BSC approach or IRB approach to calculate its credit risk for non-securitization exposures**

- (1) An authorized institution—
- (a) subject to paragraphs (b) and (c), shall use the STC approach to calculate its credit risk for non-securitization exposures;
  - (b) may use the BSC approach to calculate its credit risk for non-securitization exposures only if it has the approval to do so under section 6(2)(a);
  - (c) may use the IRB approach to calculate its credit risk for non-securitization exposures only if it has the approval to do so under section 8(2)(a).

(2) Subsection (1) does not prevent an authorized institution from using any combination of the STC approach, BSC approach and IRB approach to calculate its credit risk for non-securitization exposures if that combination is expressly permitted by, and in accordance with, another section of these Rules.