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21 March 2014

Mr He Guangbei
Chairman
The Hong Kong Association of Banks
Room 525, 5/F
Prince's Building
Central
Hong Kong

By email and by hand

Dear Mr He,

Basel III implementation – Leverage Ratio

Further to our letter of 18 December 2013, I am writing to consult the Association on a revised template and accompanying completion instructions (**Attachment 1**) for locally incorporated authorized institutions (AIs) to report their Leverage Ratio to the HKMA under the "parallel reporting" arrangements for Basel III implementation.

The revised template has been modified to reflect the final Leverage Ratio standard issued by the Basel Committee[1] in January. Modifications include:

- *Scope of consolidation* – adopting the same scope of regulatory consolidation as used for the risk-based capital framework;

- *Securities financing transactions* - allowing limited netting with the same counterparty to reduce the Leverage Ratio exposure measure, where specific conditions are met;

- *Off-balance sheet items* - converting an off-balance sheet exposure to an on-balance sheet equivalent using the same CCFs as are used in the Standardised Approach for credit risk under the Basel Committee's risk-based capital requirements, subject to a floor of 10%;

- *Cash variation margin* - reducing the Leverage Ratio exposure measure by the cash variation margin associated with derivative exposures provided specific conditions are met;

[1] As set out in the *Basel III leverage ratio framework and disclosure requirements* text released by the Basel Committee on Banking Supervision in January 2014.

- *Central clearing* – excluding a clearing member bank's trade exposures to qualifying central counterparties (QCCPs) associated with client-cleared derivatives transactions provided that the clearing member bank does not guarantee the performance of a QCCP to its clients; and

- *Written credit derivatives* – capping the effective notional amounts included in the exposure measure at the level of the maximum potential loss, and some broadening of recognition of eligible offsetting hedges.

Given that the modifications regarding scope of consolidation and off balance sheet items should make the Leverage Ratio framework more consistent with the risk-based capital framework, and that the remaining modifications are technical refinements that can readily be incorporated into the originally proposed calculation methodology, we would not expect AIs to encounter much additional difficulty in computing and reporting their Leverage Ratio based on the final framework. In drawing up the revised template, we have also had regard to comments raised by the industry in the previous consultation on the Leverage Ratio template (save for those overtaken by changes made by the Basel Committee in the final Leverage Ratio framework). Our responses to the comments raised by the Association are set out at **Attachment 2**.

We would be grateful if you would circulate this letter and the revised package to all members of the Association and let us know if the Association has any further comments by 11 April 2014. Our intention is for AIs to start submitting the template on both solo and consolidated bases beginning with the position of December 2013 and thereafter on a quarterly basis. AIs will be required to submit the template within 6 weeks from the end of a quarter.

If you have any questions to the enclosed template, please feel free to contact Miss Theresa Kwan (2878 1093) or Mr Raymond Tsui (2878 1623).

I am writing in similar terms to The DTC Association.

Yours sincerely,

Karen Kemp
Executive Director (Banking Policy)

Encl.

c.c. FSTB (Attn. Mr Jackie Liu)