Annex

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Banking (Capital) (Amendment) Rules 2012

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Contents

Section Page

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(Made by the Monetary Authority under section 97C of the Banking Ordinance (Cap. 155) 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)

1. Commencement

These Rules come into operation on 1 January 2013.

2. Banking (Capital) Rules amended

The Banking (Capital) Rules (Cap. 155 sub. leg. L) are amended as set out in sections 3 to 159.

3. Section 2 amended (interpretation)

(1) Section 2(1)—

Repeal the definition of *back-testing*

Substitute

"***back-testing*** ( ), in relation to the use of an internal model by an authorized institution—

(a) where the internal model is used to calculate counterparty credit risk, means a process whereby the realized values of risk measures and the hypothetical changes based on static positions are compared with the values of the risk measures forecast by the model; or

(b) in any other case, 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;".

(2) Section 2(1)—

Repeal the definition of *credit derivative contract*

Substitute

"***credit derivative contract*** ( ) means—

(a) 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***);

(b) a long settlement transaction that falls within paragraph (a); or

(c) a long settlement transaction of which the counterparty credit risk profile and risk drivers are similar to those specific to a contract that falls within paragraph (a);".

(3) Section 2(1)—

Repeal the definition of *credit risk*

Substitute

"***credit risk*** ( ), in relation to an authorized institution, means the risk of loss arising from the change in the value of an on-balance sheet or off-balance sheet exposure of the institution due to—

(a) the change in the credit quality of the exposure concerned; or

(b) the failure of an obligor to meet the obligor's credit obligations to the institution or to the obligor's other creditors;".

(4) Section 2(1), definition of ***derivative contract***, after paragraph (b)—

Add

"(c) means a long settlement transaction that falls within paragraph (a); or

(d) means a long settlement transaction of which the counterparty credit risk profile and risk drivers are similar to those specific to a contract that falls within paragraph (a);".

(5) Section 2(1), definition of ***foreign public sector entity***—

Repeal

"on Banking Supervision" (wherever appearing).

(6) Section 2(1), definition of ***long-term ECAI issue specific rating***—

Repeal

"79(e)" (wherever appearing)

Substitute

"79(1)(e)".

(7) Section 2(1)—

Repeal the definition of *market risk*

Substitute

"***market risk*** ( ), in relation to an authorized institution, means the risk of loss arising from fluctuations in the value of positions held by the institution—

(a) for trading purposes in debt securities, debt-related derivative contracts, interest rate derivative

contracts, equities and equity-related derivative contracts; and

(b) in foreign exchange (including gold), exchange rate-related derivative contracts, commodities and commodity-related derivative contracts;".

(8) Section 2(1)—

Repeal the definition of *nettable*

Substitute

"***nettable*** ( ), in relation to an exposure (however described) of an authorized institution—

(a) in the case of the calculation of default risk exposure using the IMM(CCR) approach, means that the exposure is subject to a valid bilateral netting agreement or a valid cross-product netting agreement; or

(b) in any other case, means that the exposure is subject to a valid bilateral netting agreement;".

(9) Section 2(1)—

Repeal the definition of *operational risk*

Substitute

"***operational risk*** ( ), in relation to an authorized institution, means the risk of direct or indirect loss resulting from—

(a) inadequacies or failings in the processes or systems, or of the personnel, of the institution; or

(b) external events;".

(10) Section 2(1)—

Repeal the definition of *over-the-counter derivative transaction*

Substitute

"***over-the-counter derivative transaction*** ( ) means a derivative contract (other than a credit derivative contract) that is not traded on an exchange;".

(11) Section 2(1), definition of ***positive current exposure***—

Repeal

"paragraph (i) or (j) of the definition of ***cash items*** in section 51(1) or 105 or referred to in paragraph (h) or (i)"

Substitute

"section 63A or 114A, referred to in paragraph (i) or (j) of the definition of ***cash items*** in section 51(1) or 105 or referred to in paragraph (h), (i) or (j)".

(12) Section 2(1)—

Repeal the definition of *potential exposure*

Substitute

"***potential exposure*** ( ), in relation to the current exposure method, means the principal amount (within the meaning of section 51(1), 105, 139(1) or 227(1), as the case requires) of a transaction or contract multiplied by the applicable CCF;".

(13) Section 2(1), definition of ***recognized credit risk mitigation***—

Repeal paragraphs (c) and (d)

Substitute

"(c) a recognized guarantee (within the meaning of section 51(1), 105 or 139(1), as the case requires);

(d) a recognized credit derivative contract (within the meaning of section 51(1), 105 or 139(1), as the case requires); or

(e) collateral that falls within section 226H(3),".

(14) Section 2(1)—

Repeal the definition of *recognized netting*

Substitute

"***recognized netting*** ( )—

(a) in the case of the calculation of default risk exposure using the IMM(CCR) approach, means any netting done pursuant to—

(i) a valid bilateral netting agreement; or

(ii) a valid cross-product netting agreement; or

(b) in any other case, means any netting done pursuant to a valid bilateral netting agreement;".

(15) Section 2(1), definition of ***risk-weighted amount***, paragraph (a), after "or 6,"—

Add

"or Division 4 of Part 6A,".

(16) Section 2(1), definition of ***risk-weighted amount for credit risk***, paragraph (a), after "or 6,"—

Add

"or Division 4 of Part 6A,".

(17) Section 2(1), definition of ***short-term ECAI issue specific rating***—

Repeal

"79(k)" (wherever appearing)

Substitute

"79(1)(k)".

(18) Section 2(1), Chinese text, definition of ***信貸換算因數***—

Repeal

"51" (wherever appearing)

Substitute

"51(1)".

(19) Section 2(1), Chinese text, definition of ***認可減低信用風險措施***—

Repeal

"51" (wherever appearing)

Substitute

"51(1)".

(20) Section 2(1), Chinese text, definition of ***潛在風險承擔***—

Repeal

"51"

Substitute

"51(1)".

(21) Section 2(1)—

(a) definition of ***Basel Committee on Banking Supervision***;

(b) definition of ***core capital***;

(c) definition of ***section 79A(1) requirement***;

(d) definition of ***section 98(2) requirement***;

(e) definition of ***supplementary capital***—

Repeal the definitions.

(22) Section 2(1)—

Add in alphabetical order

"***Additional Tier 1 capital*** ( ), in relation to an authorized institution, is to be construed in accordance with section 39;

Additional Tier 1 capital instrument ( ) means any capital instrument that meets the qualifying criteria set out in Schedule 4B;

advanced CVA method ( ) means the method of calculating an authorized institution's CVA capital charge set out in section 226P;

affiliate ( ) has the meaning given by section 35;

bank subsidiary ( ) has the meaning given by section 35;

capital adequacy ratio ( ) has the meaning given by section 3;

CCP means a central counterparty;

CCP-related transaction ( ), in relation to a clearing member of a CCP, means a derivative contract or SFT between the clearing member and a client of the clearing member that is directly related to a derivative contract or SFT between the clearing member and the CCP;

CEM risk-weighted amount ( ), in relation to derivative contracts entered into by an authorized institution, means the sum of the default risk risk-weighted amounts for all the counterparties to the contracts where the default risk risk-weighted amount for each of the counterparties is calculated as the product of—

(a) the outstanding default risk exposure (net of specific provisions if the STC approach or the BSC approach is used) to the counterparty calculated by using the current exposure method; and

(b) the risk-weight applicable to the outstanding default risk exposure determined under the BSC approach, the STC approach or the IRB approach, as the case requires;

central counterparty ( ), in relation to contracts traded in one or more than one financial market, means a person who—

(a) interposes between the counterparties to the contracts by becoming the buyer to every seller and the seller to every buyer under the contracts; and

(b) is responsible for the operation of a clearing system for the contracts;

CET1 capital ( ) means Common Equity Tier 1 capital;

CET1 capital instrument ( ) means an ordinary share or any other capital instrument that meets the qualifying criteria set out in Schedule 4A;

CET1 capital ratio ( ) means Common Equity Tier 1 capital ratio;

clearing member ( ), in relation to a CCP—

(a) means a member of, or a direct participant in, the CCP that is entitled to enter into a transaction with the CCP; or

(b) if—

(i) the CCP has a link to another CCP; and

(ii) a member of, or direct participant in, that other CCP that is entitled to enter into a transaction with that other CCP is able to clear transactions through the CCP via the link,

means that other CCP;

client ( ), in relation to a clearing member of a CCP, means a party to a transaction with the CCP through the clearing member where—

(a) the clearing member acts as a financial intermediary; or

(b) the clearing member guarantees the performance of the party to the CCP;

commercial entity ( ) has the meaning given by section 35;

Common Equity Tier 1 capital ( ), in relation to an authorized institution, is to be construed in accordance with section 38;

Common Equity Tier 1 capital ratio ( ) , in relation to an authorized institution, means, subject to sections 29, 30 and 31, the ratio, expressed as a percentage, of the amount of the institution's CET1 capital to the sum of the institution's risk-weighted amount for credit risk, risk-weighted amount for market risk, and risk-weighted amount for operational risk, as determined in accordance with these Rules;

counterparty credit risk ( ), means—

(a) counterparty default risk; and

(b) CVA risk;

counterparty default risk ( ), in relation to a derivative contract or SFT entered into by an authorized institution with a counterparty, means the risk that the counterparty could default before the final settlement of the cash flows of the contract or transaction, as the case may be;

credit valuation adjustment ( ), in relation to the calculation by an authorized institution of counterparty credit risk in respect of a counterparty, means an adjustment made by the institution to the valuation of a netting set with the counterparty to reflect the market value of the credit risk of that counterparty;

credit valuation adjustment capital charge ( ), in relation to the calculation by an authorized institution of counterparty credit risk in respect of a counterparty, means the amount of regulatory capital that the institution is required to hold for the CVA risk of the counterparty;

current exposure method ( )—

(a) in relation to an off-balance sheet exposure of an authorized institution to a counterparty under an OTC derivative transaction or credit derivative contract that is not covered by a valid bilateral netting agreement, means the method set out in section 71(2), 73, 118(2), 120, 165, 166, 181 or 182, as the case requires, for calculating the credit equivalent amount of the exposure;

(b) in relation to an off-balance sheet exposure of an authorized institution that is a net credit exposure to a counterparty arising from a portfolio of OTC derivative transactions or credit derivative contracts covered by a valid bilateral netting agreement, means the method set out in section 95, 131 or 209(2), as the case requires, for calculating the credit equivalent amount of the exposure;

CVA means a credit valuation adjustment;

CVA capital charge ( ) means a credit valuation adjustment capital charge;

CVA loss ( ), in relation to the calculation by an authorized institution of the outstanding default risk exposure to a counterparty, means the CVA (or a portion of the CVA) for the counterparty that has been recognized by the institution as an incurred write-down,

where the amount of the incurred write-down is calculated—

(a) without taking into account any amount of debit valuation adjustments made for the netting sets with the counterparty that have been deducted from the CET1 capital of the institution under section 43(1)(h); and

(b) net of any amount of debit valuation adjustments made for the netting sets with the counterparty that have not been deducted from the CET1 capital of the institution under section 43(1)(h);

CVA risk ( ) has the meaning given by section 226A;

CVA risk-weighted amount ( ), in relation to an authorized institution and the CVA capital charge for a counterparty, means the amount calculated by the institution by multiplying the CVA capital charge by 12.5;

debit valuation adjustment ( ), in relation to a netting set held by an authorized institution, means an adjustment to the valuation of the netting set to reflect the market value of the credit risk of the institution;

default fund contribution ( ), in relation to a clearing member of a CCP, means—

(a) the funded or unfunded contribution made by the clearing member to the CCP's mutualized loss-sharing arrangements; or

(b) the clearing member's underwriting of the CCP's mutualized loss-sharing arrangements;

default risk exposure ( ), in relation to the calculation by an authorized institution of counterparty credit risk in respect of a netting set with a counterparty, means the

institution's exposure to the counterparty default risk of the counterparty and—

(a) subject to paragraphs (b) and (e), if the netting set falls within paragraph (b) of the definition of ***netting set*** in this section and the transaction concerned is an OTC derivative transaction or credit derivative contract, that exposure is the credit equivalent amount (within the meaning of section 51(1), 105, 139(1) or 227(1), as the case requires) calculated using the current exposure method;

(b) subject to paragraph (e), if the netting set falls within paragraph (a) of the definition of ***netting set*** in this section and the transactions concerned are OTC derivative transactions or credit derivative contracts, that exposure is the credit equivalent amount of the net credit exposure mentioned in section 95 or 131 or the EAD mentioned in section 209(2), as the case may be, calculated using the current exposure method;

(c) subject to paragraphs (d) and (e), if the netting set falls within paragraph (b) of the definition of ***netting set*** in this section and the transaction concerned is an SFT, that exposure is the principal amount of securities sold or lent, or the money paid or lent, or the securities or money provided as collateral, as the case requires, under the SFT;

(d) subject to paragraph (e), if the netting set falls within paragraph (a) of the definition of ***netting set*** in this section and the transactions concerned are SFTs, that exposure is the net credit exposure in respect of the SFTs calculated under section 96, 97 or 209(3), as the case requires;

(e) if the netting set is covered by an IMM(CCR) approval, that exposure is the amount calculated under section 226E(1) using the IMM(CCR) approach; and

(f) if the netting set consists of one or more than one derivative contract (other than a credit derivative contract) that is traded on an exchange, that exposure is the amount mentioned in paragraph (a), (b) or (e), as the case may be, as if the contract were an OTC derivative transaction;

effective EPE ( ) means effective expected positive exposure;

effective expected positive exposure ( ), in relation to a netting set, means the amount calculated in accordance with section 226F or 226L, as the case requires;

financial sector entity ( ) has the meaning given by section 35;

IMM(CCR) approach ( ) means the internal models (counterparty credit risk) approach;

IMM(CCR) approval ( ) means an approval to use the IMM(CCR) approach granted by the Monetary Authority under section 10B(2)(a);

IMM(CCR) risk-weighted amount ( ) means the amount calculated under section 226D;

independent amount ( ), in relation to a margin agreement associated with transactions between two counterparties that are not cleared by a CCP, means collateral posted by one counterparty to the other counterparty to mitigate the potential future exposure of the other counterparty to the first counterparty arising

from the possible future change in the value of the transactions;

indirect holding ( ) has the meaning given by section 35;

insignificant capital investment ( ) has the meaning given by section 35;

internal models (counterparty credit risk) approach ( ) means the method of calculating an authorized institution's default risk exposure set out in Division 2 of Part 6A;

long settlement transaction ( ), in relation to the calculation by an authorized institution of counterparty credit risk, means a transaction or contract where a counterparty undertakes to deliver a security, commodity or foreign currency amount against cash, other financial instruments or commodities, or vice versa, at a settlement or delivery date that is contractually specified in the transaction or contract as being more than the lower of—

(a) the market standard applicable to a transaction or contract of this type; and

(b) 5 business days after the date on which the institution enters into the transaction or contract;

margin agreement ( ) has the meaning given by section 226A;

margin lending transaction ( ), in relation to the calculation by an authorized institution of counterparty credit risk—

(a) subject to paragraph (b), means a transaction under which a person extends credit in connection with the purchase, sale, carrying or trading of securities;

(b) does not include a transaction under which the credit extended is—

(i) secured by securities; and

(ii) in connection with a matter other than the purchase, sale, carrying or trading of securities;

margin period of risk ( ) has the meaning given by section 226A;

margin threshold ( ) has the meaning given by section 226A;

minimum transfer amount ( ) has the meaning given by section 226A;

netting set ( ) means—

(a) a transaction that falls within section 226J(1);

(b) a group of transactions with a counterparty (excluding any transaction that falls within section 226J(1)) that are subject to a valid bilateral netting agreement or a valid cross-product netting agreement; or

(c) a transaction with a counterparty (other than a transaction that falls within section 226J(1)) that is not subject to a valid bilateral netting agreement or a valid cross-product netting agreement;

outstanding default risk exposure ( ), in relation to a counterparty with whom the transactions entered into by an authorized institution consist of not less than one OTC derivative transaction or credit derivative contract, means the greater of—

(a) zero; and

(b) the difference between—

(i) the sum of default risk exposures across all netting sets with the counterparty; and

(ii) the CVA loss in respect of that counterparty;

section 3C requirement ( ), in relation to an authorized institution, means a requirement in a notice under section 3C specifying the basis on which the capital adequacy ratio of the institution is to be calculated;

securities financing transaction ( ) means—

(a) a repo-style transaction;

(b) a margin lending transaction;

(c) a long settlement transaction that falls within paragraph (a) or (b); or

(d) a long settlement transaction of which the counterparty credit risk profile and risk drivers are similar to those specific to a transaction that falls within paragraph (a) or (b);

SFT means a securities financing transaction;

shortcut method ( ), in relation to the IMM(CCR) approach, means the method of calculating the effective EPE to a counterparty set out in section 226L;

significant capital investment ( ) has the meaning given by section 35;

special purpose vehicle ( ) has the meaning given by section 35;

specific wrong-way risk ( ) has the meaning given by section 226A;

standardized CVA method ( ) means the method of calculating an authorized institution's CVA capital charge set out in section 226S;

synthetic holding ( ) has the meaning given by section 35;

Tier 1 capital ( ), in relation to an authorized institution, is to be construed in accordance with section 37;

Tier 1 capital ratio ( ) has the meaning given by section 35;

Tier 2 capital ( ), in relation to an authorized institution, is to be construed in accordance with section 40;

Tier 2 capital instrument ( ) means any capital instrument that meets the qualifying criteria set out in Schedule 4C;

Total capital ( ), in relation to an authorized institution, means the sum of the institution's Tier 1 capital and Tier 2 capital;

Total capital ratio ( ) has the meaning given by section 35;

valid cross-product netting agreement ( ), in relation to an authorized institution's transactions with a counterparty that are covered by an IMM(CCR) approval, has the meaning given by section 226B;".

4. Part 1A heading added

After section 2—

Add

"**Part 1A**

Capital Adequacy Ratio".

5. Section 3 substituted

Section 3—

Repeal the section

Substitute

"**3. Interpretation of Part 1A**

In this Part—

capital adequacy ratio ( ), in relation to an authorized institution, means the institution's—

(a) CET1 capital ratio;

(b) Tier 1 capital ratio; and

(c) Total capital ratio.".

6. Sections 3A, 3B and 3C added

Part 1A, after section 3—

Add

"**3A. Minimum capital adequacy ratio applicable to authorized institutions from 2013 to 2015**

Subject to any section 3C requirement that applies to an authorized institution, the institution must not—

(a) at any time during the calendar year 2013—

(i) have a CET1 capital ratio of less than 3.5%;

(ii) have a Tier 1 capital ratio of less than 4.5%; or

(iii) have a Total capital ratio of less than 8%;

(b) at any time during the calendar year 2014—

(i) have a CET1 capital ratio of less than 4%;

(ii) have a Tier 1 capital ratio of less than 5.5%; or

(iii) have a Total capital ratio of less than 8%; and

(c) at any time during the calendar year 2015—

(i) have a CET1 capital ratio of less than 4.5%;

(ii) have a Tier 1 capital ratio of less than 6%; or

(iii) have a Total capital ratio of less than 8%.

3B. Minimum capital adequacy ratio applicable to authorized institutions on and after 1 January 2016

Subject to any section 3C requirement that applies to an authorized institution, the institution must not, at any time on and after 1 January 2016—

(a) have a CET1 capital ratio of less than 4.5%;

(b) have a Tier 1 capital ratio of less than 6%; or

(c) have a Total capital ratio of less than 8%.

3C. Monetary Authority may require authorized institution that has any subsidiary to calculate capital adequacy ratio on unconsolidated or consolidated basis, etc.

(1) For the purposes of calculating the capital adequacy ratio of an authorized institution that has one or more than one subsidiary, the Monetary Authority may, by notice in writing given to the institution, require the capital adequacy ratio of the institution to be calculated—

(a) on an unconsolidated basis in respect of the institution;

(b) on a consolidated basis in respect of the institution and one or more of such subsidiaries; or

(c) on an unconsolidated basis in respect of the institution and on a consolidated basis in respect of the institution and one or more of such subsidiaries.

(2) An authorized institution given a notice under subsection (1) must comply with the requirements of the notice.".

7. Section 4 amended (interpretation of Part 2)

(1) Section 4, definition of ***consolidation group***—

Repeal

"section 98(2) requirement"

Substitute

"section 3C requirement".

(2) Section 4, definition of ***IRB coverage ratio***, after "institution's risk-weighted amount for credit risk"—

Add

"(but excluding any risk-weighted amount for credit risk of its exposures to a CCP that is subject to Division 4 of Part 6A)".

8. Section 4A amended (valuation of exposures measured at fair value)

Section 4A(1), after "6,"—

Add

"6A,".

9. Section 5 amended (authorized institution shall only use STC approach, BSC approach or IRB approach to calculate its credit risk for non-securitization exposures)

Section 5(1)—

Repeal

"An"

Substitute

"Subject to section 16A, an".

10. Section 10 amended (measures which may be taken by Monetary Authority if authorized institution using BSC approach or IRB approach no longer satisfies specified requirements)

(1) Section 10(5)—

Repeal paragraph (c)

Substitute

"(c) the Monetary Authority may, by notice in writing given to the institution, advise the institution that the Monetary Authority is considering exercising the power under section 97F of the Ordinance to vary the institution's capital adequacy ratio by increasing all or any of the following—

(i) the institution's CET1 capital ratio;

(ii) the institution's Tier 1 capital ratio;

(iii) the institution's Total capital ratio;".

(2) Section 10(7)(b)—

Repeal

"101"

Substitute

"97F".

11. Sections 10A to 10D added

Part 2, Division 2, after section 10—

Add

"**10A. Authorized institution must only use current exposure method, etc. to calculate its counterparty credit risk**

(1) Subject to subsections (2), (4) and (5), an authorized institution must—

(a) use the current exposure method to calculate its default risk exposures in respect of derivative contracts;

(b) use the method or methods set out in sections 76A(4) to (7), 96, 97, 123A(4) to (7), 202(1) or 209(3), as the case requires, to calculate its default risk exposures in respect of SFTs; and

(c) use the standardized CVA method—

(i) to calculate the CVA capital charge in respect of OTC derivative transactions and credit derivative contracts; and

(ii) if the institution is required to do so pursuant to a notice under subsection (6) given to it by the Monetary Authority, to calculate the CVA capital charge in respect of SFTs.

(2) An authorized institution may use the IMM(CCR) approach to calculate its default risk exposures in respect of derivative contracts, SFTs or long settlement transactions only if it has an IMM(CCR) approval for those contracts or transactions.

(3) Subsection (4) applies to an authorized institution that has—

(a) an IMM(CCR) approval that covers derivative contracts; and

(b) an approval granted under section 18 to use the IMM approach to calculate specific risk for interest rate exposures.

(4) An authorized institution to which this subsection applies must, unless otherwise required by the Monetary Authority under section 10C(1), or by virtue of section 10C(2), use the advanced CVA method—

(a) to calculate the CVA capital charge in respect of OTC derivative transactions and credit derivative contracts; and

(b) if the institution is required to do so pursuant to a notice under subsection (6) given to it by the Monetary Authority, to calculate the CVA capital charge in respect of SFTs.

(5) Subsection (1) does not prevent an authorized institution from using—

(a) a combination of the current exposure method and the IMM(CCR) approach; or

(b) a combination of the methods mentioned in subsection (1)(b) and the IMM(CCR) approach,

to calculate the institution's default risk exposures if that combination is expressly permitted by, and in accordance with, another provision of these Rules.

(6) Where the Monetary Authority determines that an authorized institution's CVA risk arising from SFTs is material, the Monetary Authority may, by notice in writing given to the institution, require the institution to calculate and hold a CVA capital charge in respect of its SFTs.

(7) An authorized institution must comply with the requirements of a notice given to it under subsection (6).

(8) Subsections (1), (2), (3), (4), (5), (6) and (7) apply to an authorized institution regardless of whether the contracts or transactions concerned are booked in the institution's banking book or trading book.

10B. Authorized institution may apply for approval to use IMM(CCR) approach to calculate its default risk exposures

(1) An authorized institution that has obtained the Monetary Authority's approval to use the IMM approach to calculate its market risk may apply to the Monetary Authority for approval to use the IMM(CCR) approach to calculate its default risk exposures in respect of contracts or transactions falling within any one or more of the following categories—

(a) derivative contracts (other than long settlement transactions);

(b) SFTs (other than long settlement transactions);

(c) long settlement transactions.

(2) Subject to subsection (3), the Monetary Authority must determine an application under subsection (1) from an authorized institution by—

(a) granting approval to the institution to use the IMM(CCR) approach to calculate its default risk exposures in respect of—

(i) the categories of contracts or transactions specified in the application; or

(ii) any categories of contracts or transactions that the Monetary Authority specifies in the approval; or

(b) refusing to grant the approval (whether in whole or in part).

(3) Without limiting subsection (2)(b), the Monetary Authority must refuse to grant an approval to an authorized institution to use the IMM(CCR) approach if any one or more of the requirements specified in Schedule 2A applicable to or in relation to the institution are not satisfied with respect to the institution.

(4) Subject to subsections (5) and (7), an authorized institution that has an IMM(CCR) approval must use the IMM(CCR) approach to calculate its default risk exposures in respect of all contracts and transactions that are covered by the approval.

(5) Subject to subsection (6), the Monetary Authority may specify, in an IMM(CCR) approval granted to an authorized institution, a transitional period in which the institution is permitted to use the current exposure method or the methods mentioned in section 10A(1)(b), as the case requires, to calculate its default risk exposures for contracts or transactions in respect of a portion of its business that are covered by the IMM(CCR) approval.

(6) The Monetary Authority may specify the transitional period mentioned in subsection (5) only if the authorized institution concerned has submitted to the Monetary Authority a plan for fully implementing, within a period that is reasonable in all the circumstances of the case, the IMM(CCR) approach for all contracts or transactions covered by the IMM(CCR) approval.

(7) An authorized institution may choose to use the current exposure method or the methods mentioned in section 10A(1)(b) to calculate its default risk exposures for

contracts or transactions that are covered by the IMM(CCR) approval if the institution demonstrates to the satisfaction of the Monetary Authority that its total default risk exposures to those contracts or transactions are immaterial.

(8) An authorized institution that has an IMM(CCR) approval must, for contracts or transactions that are not covered by the IMM(CCR) approval, calculate its default risk exposures in respect of those contracts or transactions in accordance with section 10A(1).

(9) Where an authorized institution uses the IMM(CCR) approach to calculate its default risk exposures, the institution must not, without the prior consent of the Monetary Authority—

(a) make any significant change to any internal model that is the subject of the institution's IMM(CCR) approval; or

(b) revert to the current exposure method or any of the methods mentioned in section 10A(1)(b).

10C. Provisions supplementary to prescribed methods for calculation of CVA capital charge

(1) An authorized institution to which section 10A(4) applies must use the advanced CVA method, unless the Monetary Authority determines that the standardized CVA method must be used, to calculate the CVA capital charge in respect of the following contracts or transactions—

(a) contracts or transactions that are not covered by the institution's IMM(CCR) approval;

(b) contracts or transactions in respect of a portion of the institution's business for which the institution is

permitted under section 10B(5) to use the current exposure method or the methods mentioned in section 10A(1)(b); and

(c) contracts or transactions for which the institution has chosen under section 10B(7) to use the current exposure method or the methods mentioned in section 10A(1)(b).

(2) Where an authorized institution's approved VaR model referred to in section 226P(1) may not reflect the risk of credit spread changes appropriately in respect of a counterparty because the VaR model does not appropriately reflect the specific risk of debt securities issued by the counterparty, the institution must use the standardized CVA method, instead of the advanced CVA method, to calculate the CVA capital charge for that counterparty.

10D. Measures that may be taken by Monetary Authority if authorized institution using IMM(CCR) approach no longer satisfies specified requirements

(1) The Monetary Authority may take one or more of the measures set out in subsections (2), (3), (4), (5) and (6) in respect of an authorized institution that is using the IMM(CCR) approach if the Monetary Authority determines that—

(a) the institution no longer satisfies one or more of the requirements specified in Schedule 2A applicable to or in relation to the institution;

(b) the institution has contravened a condition attached under section 33A(1) or (2) to its IMM(CCR) approval; or

(c) the institution fails to fully implement the IMM(CCR) approach within the period specified, under section 10B(6), in the IMM(CCR) approval.

(2) The Monetary Authority may, by notice in writing given to the authorized institution, require the institution to—

(a) use the current exposure method or the methods mentioned in section 10A(1)(b), as the case requires, instead of the IMM(CCR) approach to calculate its default risk exposures;

(b) if the institution is using the advanced CVA method to calculate the CVA capital charge in respect of contracts or transactions that are covered by the IMM(CCR) approval, use the standardized CVA method instead of the advanced CVA method to calculate the CVA capital charge,

in respect of the contracts or transactions as specified in the notice, beginning on the date, or the occurrence of the event, specified in the notice.

(3) The Monetary Authority may, by notice in writing given to the authorized institution, require the institution to—

(a) submit to the Monetary Authority a plan, within the period specified in the notice (being a period that is reasonable in all the circumstances of the case), that satisfies the Monetary Authority that, if it were implemented by the institution, the institution would cease to fall within subsection (1) within a period that is reasonable in all the circumstances of the case; and

(b) implement the plan.

(4) The Monetary Authority may, by notice in writing given to the authorized institution, advise the institution that

the Monetary Authority is considering exercising the power under section 97F of the Ordinance to vary any capital requirement rule applicable to the institution;

(5) The Monetary Authority may, by notice in writing given to the authorized institution, require the institution to calculate its default risk exposures by the use of a higher α (within the meaning of section 226E(1)) specified in the notice.

(6) The Monetary Authority may, by notice in writing given to the authorized institution, require the institution to reduce its counterparty credit risk exposures in any manner, or to adopt any measures, specified in the notice that, in the opinion of the Monetary Authority, will cause the institution to cease to fall within subsection (1) within a period that is reasonable in all the circumstances of the case, or will otherwise mitigate the effect of the institution falling within that subsection.

(7) An authorized institution must comply with the requirements of a notice given to it under subsection (2), (3), (5) or (6).

(8) To avoid doubt—

(a) the requirements specified in Schedule 2A are also applicable to and in relation to an authorized institution using the IMM(CCR) approach in respect of an internal model to which a significant change mentioned in section 10B(9)(a) relates (whether or not the institution has, in respect of that change, been given the prior consent referred to in that section) and the other provisions of this section apply accordingly; and

(b) subsection (4) does not operate to prejudice the generality of the circumstances in which the

Monetary Authority may exercise the power under section 97F of the Ordinance in respect of an authorized institution to which that subsection applies.".

12. Section 15 amended (authorized institution shall only use STC(S) approach or IRB(S) approach to calculate its credit risk for securitization exposures)

Section 15(1)—

Repeal

"section 16"

Substitute

"sections 16 and 16A".

13. Section 16 amended (authorized institution using IRB(S) approach shall use ratings-based method or supervisory formula method to calculate its credit risk for securitization exposures)

Section 16(c)—

Repeal

"deduct from its core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1250% to".

14. Part 2, Division 4A added

After section 16—

Add

"Division 4A—Calculation of Credit Risk for Exposures to CCPs, etc.

16A. Authorized institution must use Division 4 of Part 6A to calculate its credit risk for exposures to CCPs, etc.

An authorized institution must calculate in accordance with Division 4 of Part 6A—

(a) its credit risk for exposures to CCPs in respect of derivative contracts and SFTs cleared by the CCPs and, if the institution is a clearing member of any CCP, the institution's default fund contributions to that CCP;

(b) its credit risk for exposures to clearing members and clients in respect of CCP-related transactions;

(c) its credit risk for exposures to clients in respect of guarantees of the clients' performance under transactions or contracts cleared by CCPs; and

(d) its credit risk for exposures to persons who hold the collateral posted by the institution in respect of transactions or contracts cleared by CCPs.".

15. Section 19 amended (measures which may be taken by Monetary Authority if authorized institution using IMM approach no longer satisfies specified requirements)

(1) Section 19(2)—

Repeal paragraph (c)

Substitute

"(c) the Monetary Authority may, by notice in writing given to the institution, advise the institution that the Monetary Authority is considering exercising the power under section 97F of the Ordinance to vary the institution's

capital adequacy ratio by increasing all or any of the following—

(i) the institution's CET1 capital ratio;

(ii) the institution's Tier 1 capital ratio;

(iii) the institution's Total capital ratio;".

(2) Section 19(4)(b)—

Repeal

"101"

Substitute

"97F".

16. Section 21 amended (measures which may be taken by Monetary Authority if authorized institution using approach used by parent bank no longer satisfies specified requirements)

(1) Section 21(3)—

Repeal paragraph (b)

Substitute

"(b) the Monetary Authority may, by notice in writing given to the institution, advise the institution that the Monetary Authority is considering exercising the power under section 97F of the Ordinance to vary the institution's capital adequacy ratio by increasing all or any of the following—

(i) the institution's CET1 capital ratio;

(ii) the institution's Tier 1 capital ratio;

(iii) the institution's Total capital ratio;".

(2) Section 21(5)—

Repeal

"101"

Substitute

"97F".

17. Section 27 amended (authorized institution shall calculate its capital adequacy ratio on solo basis, solo-consolidated basis or consolidated basis)

Section 27(2)—

Repeal

"section 98(2) requirement"

Substitute

"section 3C requirement".

18. Section 28 amended (authorized institution may apply for approval to calculate its capital adequacy ratio on solo-consolidated basis)

Section 28(2)(a)—

Repeal

"section 98(2) requirement"

Substitute

"section 3C requirement".

19. Section 29 amended (solo basis for calculation of capital adequacy ratio)

(1) Section 29(1)(b)(i)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

(2) Section 29(1)(b)—

Repeal subparagraph (ii)

Substitute

"(ii) the amount, as determined on a solo basis, of the net book value of the institution's reserves attributable to fair value gains arising from the revaluation of the institution's holdings of land and buildings, which is not included in the Tier 2 capital of the institution; and".

(3) Section 29(2)(a)—

Repeal

"Rules; and"

Substitute

"Rules.".

(4) Section 29(2)—

Repeal paragraph (b).

20. Section 30 amended (solo-consolidated basis for calculation of capital adequacy ratio)

(1) Section 30(1)(b)(i)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

(2) Section 30(1)(b)—

Repeal subparagraph (ii)

Substitute

"(ii) the amount, as determined on a solo-consolidated basis, of the net book value of the institution's and its solo-

consolidated subsidiaries' reserves attributable to fair value gains arising from the revaluation of the institution's and its solo-consolidated subsidiaries' holdings of land and buildings, which is not included in the Tier 2 capital of the institution and its solo-consolidated subsidiaries; and".

(3) Section 30—

Repeal subsection (4).

21. Section 31 amended (consolidated basis for calculation of capital adequacy ratio)

(1) Section 31(1)(b)(i)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

(2) Section 31(1)(b)—

Repeal subparagraph (ii)

Substitute

"(ii) the amount, as determined on a consolidated basis, of the net book value of the institution's and its consolidated subsidiaries' reserves attributable to fair value gains arising from the revaluation of the institution's and its consolidated subsidiaries' holdings of land and buildings, which is not included in the Tier 2 capital of the institution and its consolidated subsidiaries; and".

(3) Section 31(4)(a)—

Repeal

"Rules; and"

Substitute

"Rules.".

(4) Section 31(4)—

Repeal paragraph (b).

22. Section 33 amended (exceptions to section 27)

(1) Section 33(2)(a)—

Repeal

"section 98(2) requirement"

Substitute

"section 3C requirement".

(2) Section 33(5)(a)—

Repeal

"section 98(2) requirement"

Substitute

"section 3C requirement".

23. Part 2, Division 7A heading amended (attachment of conditions to approvals granted under section 6(2)(a), 8(2)(a), 18(2)(a), 20(2)(a) or 25(2)(a))

Part 2, Division 7A, heading, after "**8(2)(a),**"—

Add

"**10B(2)(a),**".

24. Section 33A amended (attachment of conditions to approvals granted under section 6(2)(a), 8(2)(a), 18(2)(a), 20(2)(a) or 25(2)(a))

(1) Section 33A, heading, after "**8(2)(a),**"—

Add

"**10B(2)(a),**".

(2) Section 33A(1), after "8(2)(a),"—

Add

"10B(2)(a),".

(3) Section 33A(2), after "8(2)(a),"—

Add

"10B(2)(a),".

25. Section 34 amended (reviewable decisions)

Section 34(1), after "8(2),"—

Add

"10B(2),".

26. Part 3 substituted

Part 3—

Repeal the Part

Substitute

"Part 3

Determination of Capital Base

Division 1—General

35. Interpretation of Part 3

In this Part—

affiliate ( ), in relation to an authorized institution, means—

(a) an entity that—

(i) has a beneficial interest in, or controls, 20% or more of the total number of ordinary shares in the institution; or

(ii) is entitled to exercise, or control the exercise of, 20% or more of the voting power in the institution;

(b) an entity in which the institution or an entity falling within paragraph (a)—

(i) has a beneficial interest in, or control, 20% or more of the total number of ordinary shares; or

(ii) is entitled to exercise, or control the exercise of, 20% or more of the voting power;

bank subsidiary ( ), in relation to an authorized institution, means a subsidiary of the institution that—

(a) is a bank, or is a supervised entity as defined by section 157A(4); and

(b) is subject to consolidation under a section 3C requirement;

cash flow hedge ( ), in relation to a hedging relationship of an authorized institution, means a hedge of an exposure of the institution to variability in cash flows that—

(a) is attributable to—

(i) a particular risk associated with an asset or liability recognized on the institution's balance sheet; or

(ii) a highly probable uncommitted but anticipated future transaction; and

(b) could affect the institution's profit or loss;

commercial entity ( ) means any entity in the private sector, other than a financial sector entity;

connected company ( ), in relation to an authorized institution, means—

(a) a subsidiary, or the holding company, of the institution; or

(b) a company that falls within section 64(1)(b), (c), (d) or (e) of the Ordinance in respect of the institution;

financial sector entity ( ) means an entity that is engaged predominantly in one or more of the following activities, whether by itself or through any of its subsidiaries—

(a) banking;

(b) securities business;

(c) insurance business;

(d) financial leasing;

(e) the issuance of credit cards;

(f) portfolio management and the provision of advice in relation to portfolio management;

(g) custodial and safekeeping services;

(h) activities similar to any of the activities mentioned in any of paragraphs (a), (b), (c), (d), (e), (f) and (g);

(i) activities ancillary to the conduct of any of the activities mentioned in any of paragraphs (a), (b), (c), (d), (e), (f) and (g);

indirect holding ( ), in relation to an authorized institution, means an exposure to capital instruments issued by a financial sector entity in circumstances where the capital instruments are not held by the

institution directly but a loss of value in the instruments will result in a loss to the institution substantially equivalent to the loss in value of a direct holding;

insignificant capital investment ( ), in relation to an authorized institution, means a capital investment issued by an entity, other than an affiliate of the institution, of which the institution owns not more than 10% of the issued ordinary share capital;

reciprocal cross holding ( ) means an arrangement—

(a) under which an authorized institution holds capital instruments issued by a financial sector entity and the entity also holds capital instruments issued by the institution; and

(b) which is designed to artificially inflate the capital position of the institution and the entity;

retained earnings ( ), in relation to an authorized institution, means the amount of profits and losses of the institution brought forward pursuant to prevailing accounting standards as at a particular date, and includes—

(a) the institution's unaudited profit or loss of the current financial year; and

(b) the institution's profit or loss of the immediately preceding financial year pending audit completion;

significant capital investment ( ), in relation to an authorized institution, means a capital investment issued by—

(a) an affiliate of the institution; or

(b) an entity, other than an affiliate of the institution, of which the institution owns more than 10% of the issued ordinary share capital;

special purpose vehicle ( ), in relation to an authorized institution, means a company or any other entity—

(a) that is established by the institution for the sole purpose of raising capital for the institution; and

(b) that does not trade or conduct any business except raising capital for the institution;

synthetic holding ( ), in relation to an authorized institution, means an investment by the institution in a capital instrument the value of which is directly linked to the value of the capital instruments issued by a financial sector entity;

Tier 1 capital ratio ( ), in relation to an authorized institution, means, subject to sections 29, 30 and 31, the ratio, expressed as a percentage, of the amount of the institution's Tier 1 capital to the sum of the institution's risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk, as determined in accordance with these Rules;

Total capital ratio ( ), in relation to an authorized institution, means, subject to sections 29. 30 and 31, the ratio, expressed as a percentage, of the amount of the institution's Total capital to the sum of the institution's risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk, as determined in accordance with these Rules.

36. Determination of capital base

The capital base of an authorized institution is the sum of the institution's—

(a) Tier 1 capital; and

(b) Tier 2 capital.

Division 2—Tier 1 Capital

37. Tier 1 capital

The Tier 1 capital of an authorized institution is the sum of the institution's—

(a) CET1 capital; and

(b) Additional Tier 1 capital.

38. CET1 capital

(1) The CET1 capital of an authorized institution is the sum of the following capital items, calculated in Hong Kong dollars and after the deductions specified in Division 4 have been made in accordance with that Division—

(a) the institution's paid-up ordinary shares (comprising voting ordinary shares or other ordinary shares ranking pari passu with voting ordinary shares in all respects except the absence of voting rights) and other CET1 capital instruments except any shares issued by the institution by virtue of capitalizing any property revaluation reserves of the institution mentioned in section 40(d);

(b) the amount standing to the credit of the institution's share premium account resulting from the issue of ordinary shares or other capital instruments that fall within paragraph (a);

(c) subject to subsection (2), the institution's retained earnings and other disclosed reserves; and

(d) the applicable amount of minority interests arising from the CET1 capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties, that is recognized as consolidated CET1 capital of the institution, as calculated based on the requirements set out in sections 2(1) and 3 of Schedule 4D.

(2) An authorized institution must exclude from reserves or retained earnings, as the case requires, under subsection (1)(c)—

(a) cumulative cash flow hedge reserves that relates to the hedging of financial instruments that are not fair valued on the balance sheet (including projected cash flows);

(b) cumulative fair value gains or losses on liabilities of the institution that are valued at fair value and that result from changes in the institution's own credit risk except any debit valuation adjustments for derivative contracts arising from the institution's own credit risk referred to in section 43(1)(h) (but not including any such gains and losses that are offset by a change in the fair value of another financial instrument measured at fair value resulting from changes in the institution's own credit risk);

(c) cumulative fair value gains arising from the revaluation of the institution's holdings of land and buildings (whether for own-use or for investment purposes);

(d) fair value gains generated from any transaction or arrangement entered into between the institution and another member of the institution's

consolidation group involving the disposal of land and buildings (whether for own-use or for investment purposes) that are held by the institution, or that other member, unless otherwise approved by the Monetary Authority; and

(e) the institution's regulatory reserve for general banking risks referred to in section 40(f).

(3) To avoid doubt, any capital instruments issued to third parties via a special purpose vehicle must not be included in an authorized institution's CET1 capital.

39. Additional Tier 1 capital

(1) The Additional Tier 1 capital of an authorized institution is the sum of the following capital items, calculated in Hong Kong dollars and after the deductions specified in Division 4 have been made in accordance with that Division—

(a) the institution's capital instruments that meet the qualifying criteria set out in Schedule 4B;

(b) the amount standing to the credit of the institution's share premium account resulting from the issue of capital instruments that fall within paragraph (a); and

(c) the applicable amount of Tier 1 capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties, that is recognized as Additional Tier 1 capital of the institution on a consolidated basis, as calculated based on the requirements set out in sections 2(2) and 4 of Schedule 4D.

(2) For the purposes of subsection (1)(a), if an authorized institution issues Additional Tier 1 capital instruments to third parties through a special purpose vehicle and—

(a) the special purpose vehicle is consolidated with the institution;

(b) the capital instruments meet the qualifying criteria set out in Schedule 4B; and

(c) the only asset of the special purpose vehicle is its investment in the capital of the institution in a form that meets the qualifying criteria set out in Schedule 4B,

the capital instruments may be included in the Additional Tier 1 capital of the institution on a consolidated basis as if the institution itself had issued the capital instruments directly to the third parties.

(3) For the purposes of subsection (1)(c), if an authorized institution issues Additional Tier 1 capital instruments to third parties through a special purpose vehicle via a consolidated bank subsidiary of the institution and—

(a) the special purpose vehicle is consolidated with the bank subsidiary;

(b) the capital instruments meet the qualifying criteria set out in Schedule 4B; and

(c) the only asset of the special purpose vehicle is its investment in the capital of the bank subsidiary in a form that meets the qualifying criteria set out in Schedule 4B,

the institution may treat the capital instruments as if the bank subsidiary itself had issued the capital instruments directly to the third parties and, accordingly, may include the capital instruments in determining the

applicable amount of the capital instruments to be included in the Additional Tier 1 capital of the institution on a consolidated basis, as calculated based on the requirements set out in sections 2(2) and 4 of Schedule 4D.

Division 3—Tier 2 Capital

40. Tier 2 capital

(1) The Tier 2 capital of an authorized institution is the sum of the following capital items, calculated in Hong Kong dollars and after the deductions specified in Division 4 have been made in accordance with that Division—

(a) the institution's capital instruments that meet the qualifying criteria set out in Schedule 4C;

(b) the amount standing to the credit of the institution's share premium account resulting from the issue of capital instruments that fall within paragraph (a);

(c) the applicable amount of capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties, that is recognized as Tier 2 capital of the institution on a consolidated basis, as calculated based on the requirements set out in sections 2(2) and 5 of Schedule 4D;

(d) subject to section 41, that part of the institution's reserves and retained earnings that is attributable to fair value gains arising from—

(i) the revaluation of the institution's holdings of land and buildings except land and buildings mortgaged to the institution to secure a debt;

(ii) the revaluation of the institution's share of the net asset value of any subsidiary of the institution to the extent that the value has changed as a result of the revaluation of the subsidiary's holdings of land and buildings except land and buildings mortgaged to the subsidiary to secure a debt; and

(iii) fair value gains derived from disposal of land and buildings (whether for own-use or for investment purposes) referred to in section 38(2)(d);

(e) the shares issued by the institution through capitalizing that part of the institution's reserves and retained earnings that is attributable to fair value gains described in paragraph (d); and

(f) subject to section 42, the institution's regulatory reserve for general banking risks and collective provisions.

(2) For the purposes of subsection (1)(a), if an authorized institution issues Tier 2 capital instruments to third parties through a special purpose vehicle and—

(a) the special purpose vehicle is consolidated with the institution;

(b) the capital instruments meet the qualifying criteria set out in Schedule 4C; and

(c) the only asset of the special purpose vehicle is its investment in the capital of the institution in a form that meets the qualifying criteria set out in Schedule 4C,

the capital instruments may be included in the Tier 2 capital of the institution on a consolidated basis as if the

institution itself had issued the capital instruments directly to the third parties.

(3) For the purposes of subsection (1)(c), if an authorized institution issues Tier 2 capital instruments to third parties through a special purpose vehicle via a consolidated bank subsidiary of the institution and—

(a) the special purpose vehicle is consolidated with the bank subsidiary;

(b) the capital instruments meet the qualifying criteria set out in Schedule 4C; and

(c) the only asset of the special purpose vehicle is its investment in the capital of the bank subsidiary in a form that meets the qualifying criteria set out in Schedule 4C,

the institution may treat the capital instruments as if the bank subsidiary itself had issued the capital instruments directly to the third parties and, accordingly, may include the capital instruments in determining the applicable amount of the capital instruments to be included in the Tier 2 capital of the institution on a consolidated basis, as calculated based on the requirements set out in sections 2(2) and 5 of Schedule 4D.

41. Provisions supplementary to section 40(d)

(1) An authorized institution's reserves fall within that part of reserves described in section 40(d) only if—

(a) the institution has a clearly documented policy on the frequency and method of revaluation of its holdings of land and buildings that is satisfactory to the Monetary Authority;

(b) the institution does not depart from that policy except after consultation with the Monetary Authority;

(c) subject to paragraph (d), any revaluation of the institution's holdings of land and buildings is undertaken by an independent professional valuer;

(d) in any case where the institution demonstrates to the satisfaction of the Monetary Authority that, despite all reasonable efforts, the institution has been unable to obtain the services of an independent professional valuer to undertake the revaluation of all or part, as the case may be, of the institution's holdings of land and buildings, any revaluation of such holdings undertaken by a person who is not an independent professional valuer is endorsed in writing by an independent professional valuer;

(e) any revaluation of the institution's holdings of land and buildings is—

(i) approved by the institution's external auditors; and

(ii) explicitly reported in the institution's audited accounts; and

(f) the fair value gains mentioned in section 40(d) are recognized in accordance with applicable accounting standards and any such gains not recognized in the financial statements of the institution are excluded from the part of reserves referred to in that section.

(2) An authorized institution must not include in its Tier 2 capital more than 45% of any fair value gains of any

item mentioned in section 40(d) arising from any revaluation mentioned in that section.

(3) An authorized institution must not, in calculating its Tier 2 capital, set-off losses in respect of land and buildings which are for the institution's own use where the losses are recognized in the institution's profit or loss against unrealized gains that are reflected directly in equity through the statement of changes in equity.

(4) An authorized institution must deduct from its CET1 capital any cumulative losses of the institution arising from the institution's holdings of land and buildings below the depreciated cost value (whether or not any such land and buildings are held for the institution's own use or for investment purposes).

42. Provisions supplementary to section 40(f)

(1) Subject to subsections (2), (3) and (4), an authorized institution that uses the STC approach or BSC approach, or both, must not include in its Tier 2 capital that amount of its total regulatory reserve for general banking risks and collective provisions that exceeds 1.25% of the institution's total risk-weighted amount for credit risk, being the sum of all the institution's risk-weighted amounts (including CVA risk-weighted amount) for—

(a) all the institution's non-securitization exposures to credit risk subject to the STC approach or BSC approach, or both; and

(b) all the institution's securitization exposures to credit risk subject to the STC(S) approach.

(2) An authorized institution that uses any combination of the STC approach, BSC approach and IRB approach—

(a) subject to paragraph (b), must apportion its total regulatory reserve for general banking risks and collective provisions between the STC approach, BSC approach, IRB approach, STC(S) approach or IRB(S) approach on a pro rata basis in accordance with the proportions of the institution's risk-weighted amount for credit risk that are calculated by using the STC approach, BSC approach, IRB approach, STC(S) approach or IRB(S) approach, as the case requires;

(b) may, with the prior consent of the Monetary Authority, use its own method to apportion its total regulatory reserve for general banking risks and collective provisions between the STC approach, BSC approach, IRB approach, STC(S) approach or IRB(S) approach; and

(c) must, after it has carried out the apportionment mentioned in paragraph (a) or (b)—

(i) comply with subsection (1) in respect of that portion of its total regulatory reserve for general banking risks and collective provisions which is apportioned to the STC approach or BSC approach, or both, and the STC(S) approach; and

(ii) exclude from its Tier 2 capital that portion of its total regulatory reserve for general banking risks and collective provisions which is apportioned to the IRB approach and IRB(S) approach.

(3) Where an authorized institution uses the IRB approach—

(a) subject to subsection (2)(c)(ii) and paragraphs (b) and (c), the institution must deduct the excess of its total EL amount over its total eligible provisions from its CET1 capital in accordance with section 43(1)(i);

(b) the deduction to be made under paragraph (a) must be gross of tax effects (if any); and

(c) if the total EL amount referred to in paragraph (a) is less than the total eligible provisions mentioned in that paragraph, the institution may include the excess of the total eligible provisions over the total EL amount in its Tier 2 capital up to 0.6% of its risk-weighted amount for credit risk calculated by using the IRB approach.

(4) Subject to subsection (2)(c)(ii), where an authorized institution uses the IRB(S) approach, the institution may include that portion of its total regulatory reserve for general banking risks and collective provisions that is apportioned to the IRB(S) approach in accordance with subsection (2)(a) or (b) in its Tier 2 capital up to 0.6% of its risk-weighted amount for credit risk calculated by using the IRB(S) approach.

Division 4—Regulatory Deductions

43. Deductions from CET1 capital

(1) An authorized institution must deduct from its CET1 capital in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H—

(a) the amount of any goodwill that is recognized by the institution as an intangible asset of the

institution, net of any associated deferred tax liabilities;

(b) the amount of other intangible assets of the institution, net of any associated deferred tax liabilities;

(c) assets of any defined benefit pension fund or plan (except those of such assets to which the institution can demonstrate to the satisfaction of the Monetary Authority that it has unrestricted and unfettered access), net of the amount of obligations under the fund or plan and any associated deferred tax liabilities;

(d) subject to section 44(1), the amount of deferred tax assets, net of deferred tax liabilities (excluding those associated with and netted against the deduction of goodwill, other intangible assets and assets of any defined benefit pension fund or plan) of the institution;

(e) the amount of any gain-on-sale arising from a securitization transaction in which the institution is the originating institution;

(f) the amount of any securitization exposure of the institution that the Monetary Authority may, by notice in writing given to the institution, require the institution to deduct from its CET1 capital;

(g) the amount of any valuation adjustment made in respect of an exposure of the institution that gives rise to a reduction in the value of the exposure except—

(i) if that exposure is a financial instrument that gives rise to the cash flow hedge reserves that fall within section 38(2)(a);

(ii) such part of that amount that has been taken into account in the calculation of the amount of the institution's retained earnings or other disclosed reserves (or that part thereof) that falls within section 38(1)(c);

(h) the amount of any debit valuation adjustments made by the institution in respect of derivative contracts arising from the institution's own credit risk (which must not be offset by any accounting valuation adjustments arising from the institution's counterparty credit risk);

(i) if the institution uses the IRB approach and the institution's total EL amount mentioned in section 42(3)(a) exceeds the institution's total eligible provisions referred to in that section, the amount of the excess of the total EL amount over the total eligible provisions;

(j) any cumulative losses of the institution arising from the institution's holdings of land and buildings below the depreciated cost value referred to in section 41(4);

(k) subject to section 45, the amount of any relevant capital shortfall in respect of a subsidiary of the institution that—

(i) is a securities firm or insurance firm; and

(ii) is not the subject of consolidation under a section 3C requirement;

(l) subject to section 44(2), the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of its own CET1 capital instruments, unless already derecognized under

applicable accounting standards, calculated in accordance with Schedule 4E;

(m) subject to section 44(2), the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of CET1 capital instruments issued by any financial sector entity where that entity has a reciprocal cross holding with the institution;

(n) subject to sections 44(2) and 46(1), any capital investment in a connected company of the institution where that connected company is a commercial entity to the extent that the net book value of such investment exceeds 15% of the capital base of the institution as reported in the institution's capital adequacy ratio return as at the immediately preceding calendar quarter end date;

(o) subject to sections 44(2) and 46(2), the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of CET1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4F, if—

(i) the relevant entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are insignificant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (l) and (m);

(p) subject to sections 44(2) and 46(2), the applicable amount of the institution's direct, indirect and synthetic holdings of CET1 capital instruments

issued by financial sector entities, calculated in accordance with Schedule 4G, if—

(i) the relevant entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are significant capital investments;

(iii) the holdings do not otherwise fall within paragraphs (l) and (m);

(q) subject to sections 44(2) and 46(2)—

(i) (if the institution calculates its capital adequacy ratio on a solo basis under a section 3C requirement) the amount of the institution's direct holdings of CET1 capital instruments issued by financial sector entities that are members of the institution's consolidation group;

(ii) (if the institution calculates its capital adequacy ratio on a solo-consolidated basis under a section 3C requirement) the amount of the institution's direct holdings of CET1 capital instruments issued by financial sector entities, other than any solo-consolidated subsidiaries, that are members of the institution's consolidation group; and

(r) any amount that would otherwise be deducted from the institution's Additional Tier 1 capital under section 47 but cannot be so deducted because the institution does not have sufficient Additional Tier 1 capital to satisfy the deduction.

(2) In this section—

relevant capital shortfall ( ), in relation to a subsidiary of an authorized institution, means the amount specified in a notice under section 45(1)(b) given to the institution in respect of that subsidiary.

44. Provisions supplementary to section 43(1)(d), (l), (m), (n), (o), (p) and (q)

(1) For the purposes of determining the net deferred tax assets mentioned in section 43(1)(d), deferred tax assets may be netted with deferred tax liabilities only if the deferred tax assets and deferred tax liabilities relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority.

(2) For the purposes of paragraphs (l), (m), (n), (o), (p) and (q) of section 43(1), an authorized institution must—

(a) exclude from the holdings mentioned in those paragraphs any holdings of capital investments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(b) reduce the amount to be deducted under those paragraphs by any amount of goodwill (related to any holdings of shares falling within those paragraphs) already deducted under section 43(1)(a); and

(c) include in the amount to be deducted under those subsections potential future holdings which the institution could be contractually obliged to purchase.

45. Provisions supplementary to section 43(1)(k)

(1) Where a subsidiary of an authorized institution that is a securities firm or insurance firm fails to meet the minimum capital requirements applicable to it and fails to remedy the breach within a period as determined or prescribed by the securities regulator or insurance regulator of the securities firm or insurance firm, as the case may be, then—

(a) the institution must, as soon as practicable after it becomes aware of the failure, give notice in writing to the Monetary Authority of particulars of the securities firm or insurance firm, as the case may be, and the details of the failure; and

(b) the Monetary Authority may, by notice in writing given to the institution, and beginning on the date, or the occurrence of the event, specified in the notice, and ending on the date, or the occurrence of the event, specified in the notice, require the institution to deduct from its CET1 capital an amount that, in the opinion of the Monetary Authority, represents the shortfall of the securities firm or insurance firm, as the case may be, in meeting those minimum capital requirements.

(2) The amount to be deducted under section 43(1)(k) by an authorized institution from its CET1 capital—

(a) is in addition to any other deduction the institution is required to make under section 43 from its CET1 capital in respect of the subsidiary concerned of the institution; and

(b) represents the amount by which that subsidiary is deficient in meeting its minimum capital requirements.

(3) An authorized institution must comply with the requirements of a notice given to it under subsection (1)(b).

46. Provisions supplementary to section 43(1)(n), (o), (p) and (q)

(1) An authorized institution must treat as part of the capital investment that is to be deducted under section 43(1)(n) the aggregate amount of loans, facilities or other credit exposures provided by the institution to any connected company of the institution where the connected company is a commercial entity, except where the institution demonstrates to the satisfaction of the Monetary Authority that any such loan was made, any such facility was granted, or any such other credit exposure was incurred, in the ordinary course of the institution's business.

(2) An authorized institution must treat as part of the applicable amount of its direct holdings, indirect holdings and synthetic holdings of CET1 capital instruments that are to be deducted under section 43(1)(o), (p) and (q) the aggregate amount of any loans, facilities or other credit exposures provided by the institution to any connected company of the institution where the connected company is a financial sector entity as if such loans, facilities or other credit exposures were direct holdings, indirect holdings or synthetic holdings of the institution in the financial sector entity, except where the institution demonstrates to the satisfaction of the Monetary Authority that any such loan was made, any such facility was granted, or any such other credit exposure was incurred, in the ordinary course of the institution's business.

47. Deductions from Additional Tier 1 capital

(1) Subject to subsection (2), an authorized institution must deduct from its Additional Tier 1 capital in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H—

(a) the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of its own Additional Tier 1 capital instruments unless already derecognized under applicable accounting standards, calculated in accordance with Schedule 4E;

(b) the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of Additional Tier 1 capital instruments issued by any financial sector entity where that entity has a reciprocal cross holding with the institution;

(c) the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of Additional Tier 1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4F, if—

(i) the relevant entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are insignificant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (a) and (b);

(d) the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of Additional Tier 1 capital instruments issued by

financial sector entities, calculated in accordance with Schedule 4G, if—

(i) the relevant entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are significant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (a) and (b);

(e) (if the institution calculates its capital adequacy ratio on a solo basis under a section 3C requirement) the amount of the institution's direct holdings of Additional Tier 1 capital instruments issued by financial sector entities that are members of the institution's consolidation group;

(f) (if the institution calculates its capital adequacy ratio on a solo-consolidated basis under a section 3C requirement) the amount of the institution's direct holdings of Additional Tier 1 capital instruments issued by financial sector entities, other than any solo-consolidated subsidiaries, that are members of the institution's consolidation group; and

(g) any amount that would otherwise be deducted from the institution's Tier 2 capital under section 49 but cannot be so deducted because the institution does not have sufficient Tier 2 capital to satisfy the deduction.

(2) An authorized institution must—

(a) exclude from the holdings mentioned in subsection (1) any holdings of capital investments issued by

financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(b) reduce the amount to be deducted under subsection (1) by any amount of goodwill (related to any holdings of Additional Tier 1 capital instruments falling within those subsections) already deducted under section 43(1)(a); and

(c) include in the amount to be deducted under subsection (1) potential future holdings that the institution could be contractually obliged to purchase.

48. Deductions from Tier 2 capital

(1) Subject to subsection (2), an authorized institution must deduct from its Tier 2 capital in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H—

(a) the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of its own Tier 2 capital instruments; unless already derecognized under applicable accounting standards, calculated in accordance with Schedule 4E;

(b) the amount of any direct holdings, indirect holdings and synthetic holdings by the institution of Tier 2 capital instruments issued by any financial sector entity where that entity has a reciprocal cross holding with the institution;

(c) the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of Tier 2 capital instruments issued by financial

sector entities, calculated in accordance with Schedule 4F, if—

(i) the relevant entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are insignificant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (a) and (b);

(d) the applicable amount of the institution's direct holdings, indirect holdings and synthetic holdings of Tier 2 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4G, if—

(i) the relevant entities are not the subject of consolidation under a section 3C requirement imposed on the institution;

(ii) the holdings are significant capital investments; and

(iii) the holdings do not otherwise fall within paragraphs (a) and (b);

(e) (if the institution calculates its capital adequacy ratio on a solo basis under a section 3C requirement) the amount of the institution's direct holdings of Tier 2 capital instruments issued by financial sector entities that are members of the institution's consolidation group; and

(f) (if the institution calculates its capital adequacy ratio on a solo-consolidated basis under a section 3C requirement) the amount of the institution's direct holdings of Tier 2 capital instruments issued

by financial sector entities, other than any solo-consolidated subsidiaries, that are members of the institution's consolidation group.

(2) An authorized institution must –

(a) exclude from the holdings mentioned in subsection (1) any holdings of capital investments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(b) include in the amount to be deducted under subsection (1) potential future holdings that the institution could be contractually obliged to purchase.".

27. Section 51 amended (interpretation of Part 4)

(1) Section 51(1), definition of ***attributed risk-weight***, paragraph (c)—

Repeal

"64, 66 or 67"

Substitute

"63A, 64, 66, 67 or 68A".

(2) Section 51(1), definition of ***cash items***, paragraph (j)(i)—

Repeal

"a non-delivery-versus-payment basis"

Substitute

"a basis other than a delivery-versus-payment basis".

(3) Section 51(1), definition of ***principal amount***, after paragraph (b)(iv)—

Add

"(v) in the case of an exposure to a person arising from the person holding collateral posted by the institution in a manner that is not bankruptcy remote from the person, the fair value of the collateral;".

(4) Section 51(1)—

Add in alphabetical order

"***SFT risk-weighted amount*** ( ), in relation to SFTs, means the sum of the default risk risk-weighted amounts for all counterparties to the SFTs where the default risk risk-weighted amount for each of the counterparties is calculated as the product of—

(a) the sum of default risk exposures across all the SFTs with the counterparty calculated under section 76A(4) to (7), 96 or 97, as the case requires, net of specific provisions; and

(b) the applicable risk-weight determined under section 74(1);".

28. Section 52 amended (calculation of risk-weighted amount of exposures)

(1) Section 52(2)(a)—

Repeal

"64, 65, 66, 67 and 68"

Substitute

"63A, 64, 65, 66, 67, 68 and 68A".

(2) Section 52(3)—

Repeal paragraph (a)

Substitute

"(a) subject to paragraph (b), in the case of an authorized institution's off-balance sheet exposures that are

counterparty credit risk exposures in respect of OTC derivative transactions, credit derivative contracts or SFTs—

(i) the institution must, if it has an IMM(CCR) approval and an approval to use the IMM approach to calculate specific risk for interest rate exposures, calculate the risk-weighted amount of those off-balance sheet exposures as the sum of the amounts specified in subsection (3A)(a), (b) and (c);

(ii) the institution must, if it has an IMM(CCR) approval but does not have an approval to use the IMM approach to calculate specific risk for interest rate exposures, calculate the risk-weighted amount of those off-balance sheet exposures as the sum of the amounts specified in subsection (3A)(a), (b) and (d);

(iii) the institution must, if it does not have an IMM(CCR) approval for any of its transactions or contracts, calculate the risk-weighted amount of those off-balance sheet exposures as the sum of the CEM risk-weighted amount, the SFT risk-weighted amount, and the CVA risk-weighted amount determined using the standardized CVA method;

(aa) subject to paragraph (b), in the case of an authorized institution's off-balance sheet exposures that do not fall within paragraph (a), the institution must calculate the risk-weighted amount of each of those exposures by—

(i) converting the principal amount of the exposure, net of specific provisions, into its

credit equivalent amount in the manner set out in section 71 or 73, as the case requires; and

(ii) multiplying the credit equivalent amount by the exposure's relevant risk-weight determined under section 74;".

(3) Section 52(3)(b)—

Repeal

"paragraph (c)"

Substitute

"paragraphs (c), (d) and (e)".

(4) Section 52(3)(c)—

Repeal

"that rating."

Substitute

"that rating;".

(5) After section 52(3)(c)—

Add

"(d) if an off-balance sheet exposure of an authorized institution is a counterparty credit risk exposure in respect of OTC derivative transactions, credit derivative contracts or SFTs, the institution must not, under paragraph (b), take into account the effect of any recognized credit risk mitigation applicable to the exposure if that effect has already been taken into account in the calculation of its default risk exposures in respect of those transactions or contracts, as the case may be;

(e) if an authorized institution has bought credit protection for an exposure and the credit protection is in the form of a single-name credit default swap that falls within section 226J(1), the institution must not take into account the credit risk mitigation effect of the swap when calculating the risk-weighted amount of the exposure.".

(6) After section 52(3)—

Add

"(3A) The amounts mentioned in subsection (3)(a)(i) and (ii) are—

(a) the IMM(CCR) risk-weighted amount of the transactions or contracts concerned that are covered by the IMM(CCR) approval;

(b) the CEM risk-weighted amount or SFT risk-weighted amount, as the case may be, of the transactions or contracts concerned that are not covered by the IMM(CCR) approval or that fall within section 10B(5) or (7);

(c) the CVA risk-weighted amount determined using the advanced CVA method, the standardized CVA method, or a combination of those 2 methods that is permitted under these Rules, as the case requires; and

(d) the CVA risk-weighted amount determined using the standardized CVA method.".

29. Section 53 amended (on-balance sheet exposures and off-balance sheet exposures to be covered)

(1) Section 53—

Renumber the section as section 53(1).

(2) Section 53(1)(a)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) that under Division 4 of Part 3 are required to be deducted from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital;

(ii) that are subject to the requirements of Division 4 of Part 6A; or

(iii) that are subject to the requirements of Part 7;".

(3) Section 53(1)—

Repeal paragraph (b)

Substitute

"(b) subject to subsection (2), all the institution's exposures to counterparties—

(i) under OTC derivative transactions, credit derivative contracts or SFTs booked in its trading book; or

(ii) in respect of assets posted by the institution as collateral that are held by the counterparties in a manner that is not bankruptcy remote from the counterparties; and".

(4) After section 53(1)—

Add

"(2) Subsection (1)(b) does not apply to exposures that are subject to—

(a) deduction from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital under Division 4 of Part 3; or

(b) the requirements of Division 4 of Part 6A.".

30. Section 59 amended (bank exposures)

(1) Section 59(5)—

Repeal

"Where"

Substitute

"Subject to subsection (5A), where".

(2) After section 59(5)—

Add

"(5A) Subsection (5) does not apply to an exposure of an authorized institution to a bank in respect of a self-liquidating letter of credit that—

(a) is issued by the bank;

(b) has a maturity of less than one year; and

(c) has been confirmed by the institution.".

31. Section 63A added

After section 63—

Add

"**63A. Failed delivery on transactions entered into on non-delivery-versus-payment basis**

An authorized institution must allocate a risk-weight of 1250% to—

(a) the amount of payment made, or the current market value of the thing delivered, by the institution in respect of any transaction in securities (other than a repo-style transaction), or any transaction in foreign exchange or commodities, that—

(i) is entered into on a basis other than a delivery-versus-payment basis; and

(ii) has remained unsettled after the contractual date of payment or delivery to the institution for 5 or more business days; and

(b) the amount of any positive current exposure associated with any transaction mentioned in paragraph (a).".

32. Section 64 amended (regulatory retail exposures)

Section 64(2)(a)—

Repeal subparagraph (ii)

Substitute

"(ii) in the case of an off-balance sheet exposure in respect of an OTC derivative transaction, credit derivative contract or SFT, the amount of the exposure is—

(A) the outstanding default risk exposure in respect of the OTC derivative transaction or credit derivative contract; or

(B) the default risk exposure in respect of the SFT,

as the case requires; and".

33. Section 65 amended (residential mortgage loans)

Section 65(6)(b)(iii)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

34. Section 66 amended (other exposures which are not past due exposures)

Section 66—

Repeal subsections (1) and (2)

Substitute

"(1) This section applies to—

(a) in the case of an authorized institution's holdings of capital instruments issued by financial sector entities—

(i) insignificant capital investments that are not subject to deduction from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital under sections 43(1)(o), 47(1)(c) and 48(1)(c); and

(ii) significant capital investments that are not subject to deduction from an authorized institution's CET1 capital under section 43(1)(p); or

(b) in any other case—

(i) equities held by an authorized institution that do not fall within section 62 or 68A; and

(ii) any other on-balance sheet exposures of the institution that do not fall within any of sections 55, 56, 57, 58, 59, 60, 61, 62, 63, 63A, 64, 65, 67 and 68A (including accrued interest if subsection (5) is applicable).

(2) Subject to subsections (3) and (4), an authorized institution must allocate a risk-weight of—

(a) 100% to an exposure to which this section applies except for exposures falling within subsection (1)(a)(ii); and

(b) 250% to an exposure falling within subsection (1)(a)(ii).".

35. Section 67 amended (past due exposures)

Section 67(1)—

Repeal

"66"

Substitute

"66(2)(a)".

36. Section 68 amended (credit-linked notes)

Section 68(c)—

Repeal

"exposure, or deduct the exposure from its core capital and supplementary capital,"

Substitute

"exposure".

37. Section 68A added

After section 68—

Add

"**68A. Significant exposures to commercial entities**

(1) This section applies to—

(a) an authorized institution's holdings of shares in any commercial entity if the holdings amount to more

than 10% of the ordinary shares issued by that commercial entity; and

(b) an authorized institution's holdings of shares in any commercial entity if that commercial entity is an affiliate of the institution.

(2) Subject to section 43(1)(n), where the net book value of an authorized institution's holdings mentioned in subsection (1)(a) or (b) exceeds 15% of its capital base as reported in its capital adequacy ratio return as at the immediately preceding calendar quarter end date, the institution must allocate a risk-weight of 1250% to that amount of the net book value of the holdings that exceeds that 15%.".

38. Section 69 amended (application of ECAI ratings)

Section 69—

Repeal subsections (3) and (4)

Substitute

"(3) Subject to subsections (5) and (8), where an exposure (however described) of an authorized institution that falls within any subsection of section 55, 57, 59, 60 or 61 does not have an ECAI issue specific rating, and the person to whom the institution has the exposure does not have an ECAI issuer rating but has a long-term ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person, the institution must, in complying with the requirements under that subsection of section 55, 57, 59, 60 or 61, as the case may be, in relation to the exposure—

(a) use the long-term ECAI issue specific rating if—

(i) the exposure ranks equally with, or is subordinated in respect of payment or repayment to, the debt obligation; and

(ii) the use of the long-term ECAI issue specific rating by the institution would result in the allocation by the institution of a risk-weight to the exposure that would be equal to, or higher than, the risk-weight allocated by the institution to the exposure on the basis that the person has neither an ECAI issuer rating nor an ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person;

(b) use the long-term ECAI issue specific rating if—

(i) the exposure ranks equally with, or senior in respect of payment or repayment to, the debt obligation; and

(ii) the use of the long-term ECAI issue specific rating by the institution would result in the allocation by the institution of a risk-weight to the exposure that would be lower than the risk-weight allocated by the institution to the exposure on the basis that the person has neither an ECAI issuer rating nor an ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person.

(4) Subject to subsections (5) and (8), where an exposure (however described) of an authorized institution that falls within any subsection of section 55, 57, 59, 60 or 61 does not have an ECAI issue specific rating, and the person to whom the institution has the exposure has an ECAI issuer rating but does not have a long-term ECAI

issue specific rating assigned to a debt obligation issued or undertaken by the person, the institution must, in complying with the requirements under that subsection of section 55, 57, 59, 60 or 61, as the case may be, in relation to the exposure—

(a) use the ECAI issuer rating if—

(i) the use of the ECAI issuer rating by the institution would result in the allocation by the institution of a risk-weight to the exposure that would be equal to, or higher than, the risk-weight allocated by the institution to the exposure on the basis that the person has neither an ECAI issuer rating nor an ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person;

(ii) the ECAI issuer rating is only applicable to unsecured exposures to the person as an issuer that are not subordinated to other exposures to that person; and

(iii) the exposure to the person ranks equally with, or is subordinated to, the unsecured exposures mentioned in subparagraph (ii);

(b) use the ECAI issuer rating if—

(i) the use of the ECAI issuer rating by the institution would result in the allocation by the institution of a risk-weight to the exposure that would be lower than the risk-weight allocated by the institution to the exposure on the basis that the person has neither an ECAI issuer rating nor an ECAI issue specific rating assigned to a debt obligation issued or undertaken by the person;

(ii) the ECAI issuer rating is only applicable to unsecured exposures to the person as an issuer that are not subordinated to other exposures to that person; and

(iii) the exposure to the person is not subordinated to other exposures to the person as an issuer.".

39. Section 70A added

Part 4, Division 4, before section 71—

Add

"**70A. Application of sections 71(2) and (3), 72 and 73(b) and (c)**

Sections 71(2) and (3), 72 and 73(b) and (c) do not apply to OTC derivative transactions or credit derivative contracts for which an authorized institution has an IMM(CCR) approval except for transactions or contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.".

40. Section 74 amended (determination of risk-weights applicable to off-balance sheet exposures)

(1) Section 74(1)—

Repeal

"subsection (2)"

Substitute

"subsections (2) and (6A)".

(2) Section 74(1)—

Repeal

"64, 65, 66 and 67"

Substitute

"63A, 64, 65, 66, 67 and 68A".

(3) Section 74(3)(a)—

Repeal

"risk-weight, or deduct the exposure from the institution's core capital and supplementary capital,"

Substitute

"risk-weight".

(4) Section 74(4)(a)—

Repeal

"risk-weight, or deduct the exposure from the institution's core capital and supplementary capital,"

Substitute

"risk-weight".

(5) After section 74(6)—

Add

"(6A) Where an off-balance sheet exposure mentioned in subsection (1) of an authorized institution arises from a single-name credit default swap that falls within section 226J(1) and the default risk exposure in respect of the swap is determined in accordance with section 226J(3), the institution must determine the risk-weight attributable to the exposure by reference to the attributed risk-weight of the counterparty in respect of the swap without taking into account any recognized credit risk mitigation afforded to the swap.".

41. Section 75 amended (calculation of risk-weighted amount of exposures in respect of repo-style transactions booked in banking book)

(1) Section 75, heading—

Repeal

"**repo-style transactions**"

Substitute

"**assets underlying SFTs**".

(2) Section 75(1)—

Repeal

"a repo-style transaction"

Substitute

"the asset underlying an SFT".

(3) Section 75(2)—

Repeal

"Where the repo-style transaction"

Substitute

"Subject to subsection (5), where the SFT is a repo-style transaction that".

(4) Section 75—

Repeal subsection (3).

(5) Section 75(4)—

Repeal

"Where the repo-style transaction"

Substitute

"Subject to subsection (5), where the SFT is a repo-style transaction that".

(6) Section 75(4)—

Repeal paragraph (a).

(7) After section 75(4)—

Add

"(5) Where the asset underlying an SFT is a securitization issue, an authorized institution must determine the risk-weight attributable to the asset in accordance with Part 7.".

42. Section 76 amended (calculation of risk-weighted amount of exposures in respect of repo-style transactions booked in trading book)

(1) Section 76, heading—

Repeal

"**repo-style transactions**"

Substitute

"**assets underlying SFTs**".

(2) Section 76—

Repeal

"a repo-style transaction"

Substitute

"the asset underlying an SFT".

(3) Section 76(a)—

Repeal

"securities;"

Substitute

"securities.".

(4) Section 76—

Repeal paragraph (b).

43. Section 76A added

Part 4, Division 4, after section 76—

Add

"**76A. Calculation of risk-weighted amount of default risk exposures in respect of SFTs**

(1) Where an authorized institution does not have an IMM(CCR) approval for SFTs, the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) in accordance with subsections (4), (5), (6) and (7).

(2) Subject to subsection (3), an authorized institution that has an IMM(CCR) approval for SFTs must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) using the IMM(CCR) approach.

(3) Where—

(a) an authorized institution has an IMM(CCR) approval for SFTs but the approval does not include SFTs that are long settlement transactions; or

(b) an authorized institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods mentioned in section 10A(1)(b) for certain SFTs,

the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) that are not, by virtue of the circumstance mentioned in paragraph (a)

or (b), subject to the IMM(CCR) approach, in accordance with subsections (4), (5), (6) and (7).

(4) Where the SFT is a repo-style transaction that falls within paragraph (a) or (b) of the definition of ***repo-style transaction*** in section 2(1), the authorized institution must treat the securities sold or lent under the transaction as if they were an on-balance sheet exposure to the counterparty secured on the money or securities that are provided to, or to the order of, the institution under the transaction and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(5) Where the SFT is a repo-style transaction that falls within paragraph (c) of the definition of ***repo-style transaction*** in section 2(1), the authorized institution must treat the money paid by the institution under the transaction as if it were a loan to the counterparty secured on the securities that are provided to, or to the order of, the institution under the transaction and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(6) Where the SFT is a margin lending transaction, the authorized institution must calculate the risk-weighted amount of its default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any

recognized credit risk mitigation applicable to the transaction.

(7) Where the SFT is a repo-style transaction that falls within paragraph (d) of the definition of ***repo-style transaction*** in section 2(1)—

(a) if and to the extent that the authorized institution has provided collateral in the form of money under the transaction, the institution must treat the money paid by the institution under the transaction as if it were a loan to the counterparty secured on the securities borrowed by the institution and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction;

(b) if and to the extent that the authorized institution has provided collateral in the form of securities under the transaction, the institution must treat those securities as if they were an on-balance sheet exposure to the counterparty secured on the securities borrowed by the institution and, accordingly, calculate the risk-weighted amount of its default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.".

44. Section 77 amended (recognized collateral)

(1) After section 77(e)—

Add

"(ea) if the collateral is provided under a margin agreement for OTC derivative transactions, credit derivative contracts or SFTs, the institution has—

(i) devoted sufficient resources to enable the orderly operation of the agreement; and

(ii) has collateral management policies in place to control, monitor and report—

(A) risks (including liquidity risk and concentration risk) associated with the agreement;

(B) reuse of collateral; and

(C) the rights ceded by the institution in respect of collateral posted;".

(2) Section 77(f)—

Repeal

"such that the current market value of the collateral would be likely to fall in the case of any material deterioration in the financial condition of the obligor".

(3) Section 77(i)(i)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

(4) Section 77(i)(ii)—

Repeal

"80(a)"

Substitute

"80(1)(a)".

45. Section 79 amended (collateral which may be recognized for purposes of section 77(i)(i))

(1) Section 79—

Renumber the section as section 79(1).

(2) Section 79(1)—

Repeal

"For"

Substitute

"Subject to subsection (2), for".

(3) After section 79(1)—

Add

"(2) Any reference to debt securities in subsection (1) does not include debt securities that, if treated as an on-balance sheet exposure of an authorized institution, would fall within the definition of ***re-securitization exposure*** in section 2(1).".

46. Section 80 amended (collateral which may be recognized for purposes of section 77(i)(ii))

(1) Section 80—

Renumber the section as section 80(1).

(2) Section 80(1)—

Repeal

"For"

Substitute

"Subject to subsection (2), for".

(3) Section 80(1)(a)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

(4) After section 80(1)—

Add

"(2) Collateral referred to in subsection (1) does not include debt securities that, if treated as an on-balance sheet exposure of an authorized institution, would fall within the definition of ***re-securitization exposure*** in section 2(1).".

47. Section 81 amended (calculation of risk-weighted amount of exposures taking into account credit risk mitigation effect of recognized collateral under simple approach)

Section 81(2)(a)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

48. Section 82 amended (determination of risk-weight to be allocated to recognized collateral under simple approach)

Section 82(5), definition of ***cash***, paragraph (b)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

49. Section 85 amended (calculation of risk-weighted amount of OTC derivative transactions and credit derivative contracts)

Section 85(1)—

Repeal paragraphs (a) to (d)

Substitute

"(a) dividing the outstanding default risk exposure of the transaction, net of specific provisions, into—

(i) the credit protection covered portion; and

(ii) the credit protection uncovered portion;

(b) multiplying the credit protection covered portion by the risk-weight attributable to the recognized collateral and multiplying the credit protection uncovered portion by the risk-weight attributable to the exposure; and

(c) adding together the 2 products derived from the application of paragraph (b).".

50. Section 88 amended (calculation of net credit exposure of off-balance sheet exposures other than credit derivative contracts booked in trading book or OTC derivative transactions)

(1) Section 88, heading—

Repeal

"**booked in trading book**".

(2) Section 88—

Repeal

"booked in the trading book of the institution".

(3) Section 88, Formula 3, heading—

Repeal

"**Booked in the Trading Book**".

51. Section 89 amended (calculation of net credit exposure of credit derivative contracts booked in trading book and OTC derivative transactions)

(1) Section 89, heading—

Repeal

"**booked in trading book**".

(2) Section 89—

Repeal

"booked in the trading book of the institution".

(3) Section 89, Formula 4, heading—

Repeal

"**Booked in Trading Book**".

(4) Section 89, Formula 4, component E—

Repeal

"credit equivalent amount of off-balance sheet exposure (calculated by aggregating the potential exposure and current exposure in respect of the credit derivative contract or OTC derivative transaction, as the case may be) net of specific provisions, if any;"

Substitute

"outstanding default risk exposure of the contract or transaction, as the case may be, net of specific provisions, if any;".

52. Section 91 amended (minimum holding periods)

(1) Section 91—

Renumber the section as section 91(1).

(2) After section 91(1)—

Add

"(2) Where the exposure mentioned in subsection (1) arises from a netting set that falls within any of the description in section 226M(2), (3) or (5), the assumed minimum holding period of the netting set must be equal to the longer margin period of risk that would apply to the netting set under section 226M(2), (3) or (5), as the case requires.".

53. Section 92 amended (adjustment of standard supervisory haircuts in certain circumstances)

Section 92, Formula 6, component T_M—

Repeal

"as set out in Table 12"

Substitute

"determined in accordance with section 91".

54. Section 94A added

Part 4, Division 8, after section 94—

Add

"**94A. Application of sections 95, 96 and 97**

(1) Where an authorized institution uses the IMM(CCR) approach to calculate the default risk exposure of a netting set that contains OTC derivative transactions or credit derivative contracts—

(a) subject to paragraph (b), the institution must take into account the effect of any recognized netting in the manner set out in Part 6A instead of in the manner set out in section 95;

(b) paragraph (a) does not apply in the case of OTC derivative transactions or credit derivative contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.

(2) Where an authorized institution uses the IMM(CCR) approach to calculate the default risk exposure of a netting set that contains SFTs—

(a) subject to paragraph (b), the institution must take into account the effect of any recognized netting in the manner set out in Part 6A instead of in the manner set out in section 96 or 97;

(b) paragraph (a) does not apply in the case of SFTs for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods mentioned in section 10A(1)(b).".

55. Section 95 amended (netting of OTC derivative transactions and netting of credit derivative contracts booked in trading book)

(1) Section 95, heading—

Repeal

"**booked in trading book**".

(2) Section 95(6), definition of ***derivative transaction***, paragraph (b)—

Repeal

"booked in the trading book".

56. Section 96 amended (netting of repo-style transactions)

(1) Section 96(2)(b)(i)—

Repeal

"80(a)"

Substitute

"80(1)(a)".

(2) Section 96(5)(b)(ii)—

Repeal

"80(a)"

Substitute

"80(1)(a)".

57. Section 97 amended (use of value-at-risk model instead of Formula 9)

(1) Section 97(4)—

Repeal paragraph (b).

(2) Section 97(4)(c)—

Repeal

"exposed."

Substitute

"exposed;".

(3) After section 97(4)(c)—

Add

"(d) if the nettable repo-style transactions are subject to daily remargining, the model will assume a minimum holding period of 5 business days and that minimum holding period—

(i) will be subject to increase to the extent that the liquidity of the securities provided by way of collateral under those transactions is such that a

longer minimum holding period should be assumed; and

(ii) will be increased in the manner set out in section 226M(2), (3) or (5), as the case requires, if those transactions constitute a netting set that falls within that section; and

(e) if the nettable repo-style transactions are not subject to daily remargining, the model will assume a minimum holding period that is at least equal to the minimum holding period calculated by the use of Formula 9A.

Formula 9A

Calculation of Minimum Holding Period where Section 97(4)(e) is Applicable

Minimum holding period = F + N -1

where—

F = 5 business days or the supervisory floor determined in accordance with section 226M(2) or (3), as the case may be; and

N = actual number of days between each remargining of the transactions.".

58. Section 98 amended (recognized guarantees)

(1) Section 98(a)(v), after "firm;"—

Add

"or".

(2) Section 98(a)—

Repeal subparagraphs (vi) and (vii)

Substitute

"(vi) a corporate that has an ECAI issuer rating,".

59. Section 99 amended (recognized credit derivative contracts)

(1) Section 99(1)(b)(v), after "firm;"—

Add

"or".

(2) Section 99(1)(b)—

Repeal subparagraphs (vi) and (vii)

Substitute

"(vi) a corporate that has an ECAI issuer rating,".

60. Section 100 amended (capital treatment of recognized guarantees and recognized credit derivative contracts)

Section 100—

Repeal subsection (9)

Substitute

"(9) Where the credit protection covered portion of an authorized institution's exposure is such credit protection covered portion by virtue of a recognized guarantee (***original guarantee***) and is the subject of a counter-guarantee given by a sovereign, the institution may, in respect of the credit protection covered portion, treat the counter-guarantee as if it were the original guarantee if—

(a) the counter-guarantee covers all credit risk elements of the exposure to the extent that it relates to the credit protection covered portion;

(b) the counter-guarantee is given in such terms that it can be called if—

(i) for any reason the obligor in respect of the exposure to which the original guarantee relates fails to make payments due in respect of the exposure; and

(ii) the original guarantee could be called;

(c) the original guarantee and the counter-guarantee meet all of the requirements for guarantees set out in section 98 (except that the counter-guarantee need not meet the requirements set out in section 98(b) and (c)); and

(d) the institution reasonably considers the cover of the counter-guarantee to be adequate and effective and there is no evidence to suggest that the coverage of the counter-guarantee is less effective than that of a direct and explicit guarantee by the sovereign that gives the counter-guarantee.".

61. Section 101 amended (provisions supplementary to section 100)

(1) Section 101(2)—

Repeal

"deduct the first loss portion from its core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1250% to the first loss portion".

(2) Section 101(8)(c)—

Repeal

"deduct from the institution's core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1250% to".

62. Section 103 amended (maturity mismatches)

Section 103(4)—

Repeal

"79(a)"

Substitute

"79(1)(a)".

63. Section 105 amended (interpretation of Part 5)

(1) Section 105, definition of ***attributed risk-weight***—

Repeal

"113 and 116"

Substitute

"113, 114A, 116 and 117A".

(2) Section 105, definition of ***cash items***, paragraph (j)(i)—

Repeal

"a non-delivery-versus-payment basis"

Substitute

"a basis other than a delivery-versus-payment basis".

(3) Section 105, definition of ***principal amount***, after paragraph (b)(iv)—

Add

"(v) in the case of an exposure to a person arising from the person holding collateral posted by the institution in a manner that is not bankruptcy remote from the person, the fair value of the collateral;".

(4) Section 105—

Add in alphabetical order

"***SFT risk-weighted amount*** ( ), in relation to SFTs, means the sum of the default risk risk-weighted amounts for all counterparties to the SFTs where the default risk risk-weighted amount for each of the counterparties is calculated as the product of—

(a) the sum of default risk exposures across all the SFTs with the counterparty calculated under section 123A(4) to (7), net of specific provisions; and

(b) the applicable risk-weight determined under section 121(1);".

64. Section 106 amended (calculation of risk-weighted amount of exposures)

(1) Section 106(3)—

Repeal paragraph (a)

Substitute

"(a) subject to paragraph (b), in the case of an authorized institution's off-balance sheet exposures that are counterparty credit risk exposures in respect of OTC derivative transactions, credit derivative contracts or SFTs—

(i) the institution must, if it has an IMM(CCR) approval and an approval to use the IMM approach to calculate specific risk for interest rate exposures, calculate the risk-weighted amount of those off-balance sheet exposures as the sum of the amounts specified in subsection (4)(a), (b) and (c);

(ii) the institution must, if it has an IMM(CCR) approval but does not have an approval to use the IMM approach to calculate specific risk for interest rate exposures, calculate the risk-weighted amount

of those off-balance sheet exposures as the sum of the amounts specified in subsection (4)(a), (b) and (d);

(iii) the institution must, if it does not have an IMM(CCR) approval for any of its transactions or contracts, calculate the risk-weighted amount of those off-balance sheet exposures as the sum of the CEM risk-weighted amount, the SFT risk-weighted amount, and the CVA risk-weighted amount determined using the standardized CVA method;

(aa) subject to paragraph (b), in the case of an authorized institution's off-balance sheet exposures that do not fall within paragraph (a), the institution must calculate the risk-weighted amount of each of those exposures by—

(i) converting the principal amount of the exposure, net of specific provisions, into its credit equivalent amount in the manner set out in section 118 or 120, as the case requires; and

(ii) multiplying the credit equivalent amount by the exposure's relevant risk-weight determined under section 121;".

(2) Section 106(3)—

Repeal paragraph (b)

Substitute

"(b) subject to paragraphs (c) and (d), an authorized institution may reduce the risk-weighted amount of the institution's off-balance sheet exposure by taking into account the effect of any recognized credit risk mitigation in respect of the exposure in the manner set out in Divisions 5, 6, 7 and 8;

(c) if an off-balance sheet exposure of an authorized institution is a counterparty credit risk exposure in respect of OTC derivative transactions, credit derivative contracts or SFTs, the institution must not, under paragraph (b), take into account the effect of any recognized credit risk mitigation applicable to the exposure if that effect has already been taken into account in the calculation of its default risk exposures in respect of those transactions or contracts, as the case may be;

(d) if an authorized institution has bought credit protection for an exposure and the credit protection is in the form of a single-name credit default swap that falls within section 226J(1), the institution must not take into account the credit risk mitigation effect of the swap when calculating the risk-weighted amount of the exposure.".

(3) After section 106(3)—

Add

"(4) The amounts mentioned in subsection (3)(a)(i) and (ii) are—

(a) the IMM(CCR) risk-weighted amount of the transactions or contracts concerned that are covered by the IMM(CCR) approval;

(b) the CEM risk-weighted amount or SFT risk-weighted amount, as the case may be, of the transactions or contracts concerned that are not covered by the IMM(CCR) approval or that fall within section 10B(5) or (7);

(c) the CVA risk-weighted amount determined using the advanced CVA method, the standardized CVA method, or a combination of those 2 methods that

is permitted under these Rules, as the case requires; and

(d) the CVA risk-weighted amount determined using the standardized CVA method.".

65. Section 107 amended (on-balance sheet exposures and off-balance sheet exposures to be covered)

(1) Section 107—

Renumber the section as section 107(1).

(2) Section 107(1)(a)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) that under Division 4 of Part 3 are required to be deducted from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital;

(ii) that are subject to the requirements of Division 4 of Part 6A; or

(iii) that are subject to the requirements of Part 7;".

(3) Section 107(1)—

Repeal paragraph (b)

Substitute

"(b) subject to subsection (2), all of the institution's exposures to counterparties—

(i) under OTC derivative transactions, credit derivative contracts or SFTs booked in its trading book; or

(ii) in respect of assets posted by the institution as collateral that are held by the counterparties in a

manner that is not bankruptcy remote from the counterparties; and".

(4) After section 107(1)—

Add

"(2) Subsection (1)(b) does not apply to exposures that are subject to—

(a) deduction from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital under Division 4 of Part 3; or

(b) the requirements of Division 4 of Part 6A.".

66. Section 114A added

After section 114—

Add

"**114A. Failed delivery on transactions entered into on non-delivery-versus-payment basis**

An authorized institution must allocate a risk-weight of 1250% to—

(a) the amount of payment made, or the current market value of the thing delivered, by the institution in respect of any transaction in securities (other than a repo-style transaction), or any transaction in foreign exchange or commodities, that —

(i) is entered into on a basis other than a delivery-versus-payment basis; and

(ii) has remained unsettled after the contractual date of payment or delivery to the institution for 5 or more business days; and

(b) the amount of any positive current exposure associated with any transaction mentioned in paragraph (a).".

67. Section 116 amended (other exposures)

Section 116—

Repeal subsections (1) and (2)

Substitute

"(1) This section applies to—

(a) in the case of an authorized institution's holdings of capital instruments issued by financial sector entities—

(i) insignificant capital investments that are not subject to deduction from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital under sections 43(1)(o), 47(1)(c) and 48(1)(c); and

(ii) significant capital investments that are not subject to deduction from an authorized institution's CET1 capital under section 43(1)(p); or

(b) in any other case—

(i) equities held by an authorized institution that do not fall within section 117A; and

(ii) any other on-balance sheet exposures of the institution that do not fall within any of sections 109, 110, 111, 112, 113, 114, 114A, 115 and 117A (including accrued interest if subsection (5) is applicable).

(2) Subject to subsections (3) and (4), an authorized institution must allocate a risk-weight of—

(a) 100% to an exposure to which this section applies except for exposures falling within subsection (1)(a)(ii); and

(b) 250% to an exposure falling within subsection (1)(a)(ii).".

68. Section 117A added

Part 5, Division 3, after section 117—

Add

"**117A. Significant exposures to commercial entities**

(1) This section applies to—

(a) an authorized institution's holdings of shares in any commercial entity if the holdings amount to more than 10% of the ordinary shares issued by that commercial entity; and

(b) an authorized institution's holdings of shares in any commercial entity if that commercial entity is an affiliate of the institution.

(2) Subject to section 43(1)(n), where the net book value of an authorized institution's holdings mentioned in subsection (1)(a) or (b) exceeds 15% of its capital base as reported in its capital adequacy ratio return as at the immediately preceding calendar quarter end date, the institution must allocate a risk-weight of 1250% to that amount of the net book value of the holdings that exceeds that 15%.".

69. Section 117B added

Part 5, Division 4, before section 118—

Add

"**117B. Application of sections 118(2) and (3), 119 and 120(b) and (c)**

Sections 118(2) and (3), 119 and 120(b) and (c) do not apply to OTC derivative transactions or credit derivative contracts for which an authorized institution has an IMM(CCR) approval except for transactions or contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.".

70. Section 121 amended (determination of risk-weights applicable to off-balance sheet exposures)

(1) Section 121(1)—

Repeal

"subsection (2)"

Substitute

"subsections (2) and (6A)".

(2) Section 121(1)—

Repeal

"115 and 116"

Substitute

"114A, 115, 116 and 117A".

(3) After section 121(6)—

Add

"(6A) Where an off-balance sheet exposure mentioned in subsection (1) of an authorized institution arises from a single-name credit default swap that falls within section 226J(1) and the default risk exposure in respect of the swap is determined in accordance with section 226J(3), the institution must determine the risk-weight attributable to the exposure by reference to the attributed

risk-weight of the counterparty in respect of the swap without taking into account any recognized credit risk mitigation afforded to the swap.".

71. Section 122 amended (calculation of risk-weighted amount of exposures in respect of repo-style transactions booked in banking book)

(1) Section 122, heading—

Repeal

"**repo-style transactions**"

Substitute

"**assets underlying SFTs**".

(2) Section 122(1)—

Repeal

"a repo-style transaction"

Substitute

"the asset underlying an SFT".

(3) Section 122(2)—

Repeal

"Where the repo-style transaction"

Substitute

"Subject to subsection (5), where the SFT is a repo-style transaction that".

(4) Section 122—

Repeal subsection (3).

(5) Section 122(4)—

Repeal

"Where the repo-style transaction"

Substitute

"Subject to subsection (5), where the SFT is a repo-style transaction that".

(6) Section 122(4)—

Repeal paragraph (a).

(7) After section 122(4)—

Add

"(5) Where the asset underlying an SFT is a securitization issue, an authorized institution must determine the risk-weight attributable to the asset in accordance with Part 7.".

72. Section 123 amended (calculation of risk-weighted amount of exposures in respect of repo-style transactions booked in trading book)

(1) Section 123, heading—

Repeal

"**repo-style transaction**s"

Substitute

"**assets underlying SFTs**".

(2) Section 123—

Repeal

"a repo-style transaction"

Substitute

"the asset underlying an SFT".

(3) Section 123(a)—

Repeal

"securities;"

Substitute

"securities.".

(4) Section 123—

Repeal paragraph (b).

73. Section 123A added

Part 5, Division 4, after section 123—

Add

"**123A. Calculation of risk-weighted amount of default risk exposures in respect of SFTs**

(1) Where an authorized institution does not have an IMM(CCR) approval for SFTs, the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) in accordance with subsections (4), (5), (6) and (7).

(2) Subject to subsection (3), an authorized institution that has an IMM(CCR) approval for SFTs must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) using the IMM(CCR) approach.

(3) Where—

(a) an authorized institution has an IMM(CCR) approval for SFTs but the approval does not include SFTs that are long settlement transactions; or

(b) an authorized institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods mentioned in section 10A(1)(b) for certain SFTs,

the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) that are not, by virtue of the circumstance mentioned in paragraph (a) or (b), subject to the IMM(CCR) approach, in accordance with subsections (4), (5), (6) and (7).

(4) Where the SFT is a repo-style transaction that falls within paragraph (a) or (b) of the definition of ***repo-style transaction*** in section 2(1), the authorized institution must treat the securities sold or lent under the transaction as if they were an on-balance sheet exposure to the counterparty secured on the money or securities that are provided to, or to the order of, the institution under the transaction and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(5) Where the SFT is a repo-style transaction that falls within paragraph (c) of the definition of ***repo-style transaction*** in section 2(1), an authorized institution must treat the money paid by the institution under the transaction as if it were a loan to the counterparty secured on the securities that are provided to, or to the order of, the institution under the transaction and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(6) Where the SFT is a margin lending transaction, the authorized institution must calculate the risk-weighted amount of its default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction.

(7) Where the SFT is a repo-style transaction that falls within paragraph (d) of the definition of ***repo-style transaction*** in section 2(1)—

(a) if and to the extent that the authorized institution has provided collateral in the form of money under the transaction, the institution must treat the money paid by the institution under the transaction as if it were a loan to the counterparty secured on the securities borrowed by the institution and, accordingly, calculate the risk-weighted amount of the institution's default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the application of any recognized credit risk mitigation applicable to the transaction;

(b) if and to the extent that the authorized institution has provided collateral in the form of securities under the transaction, the institution must treat those securities as if they were an on-balance sheet exposure to the counterparty secured on the securities borrowed by the institution and, accordingly, calculate the risk-weighted amount of its default risk exposure in respect of the transaction by reference to the attributed risk-weight of the counterparty subject to the

application of any recognized credit risk mitigation applicable to the transaction.".

74. Section 124 amended (recognized collateral)

(1) After section 124(e)—

Add

"(ea) if the collateral is provided under a margin agreement for OTC derivative transactions, credit derivative contracts or SFTs, the institution has—

(i) devoted sufficient resources to enable the orderly operation of the agreement; and

(ii) has collateral management policies in place to control, monitor and report—

(A) risks (including liquidity risk and concentration risk) associated with the agreement;

(B) reuse of collateral; and

(C) the rights ceded by the institution in respect of collateral posted;".

(2) Section 124(f)—

Repeal

"such that the current market value of the collateral would be likely to fall in the case of any material deterioration in the financial condition of the obligor".

(3) Section 124(h)—

Repeal

"125(a)"

Substitute

"125(1)(a)".

75. Section 125 amended (collateral which may be recognized for purposes of section 124(h))

(1) Section 125—

Renumber the section as section 125(1).

(2) Section 125(1)—

Repeal

"For"

Substitute

"Subject to subsection (2), for".

(3) After section 125(1)—

Add

"(2) Any reference to debt securities in subsection (1) does not include debt securities that, if treated as an on-balance sheet exposure of an authorized institution, would fall within the definition of ***re-securitization exposure*** in section 2(1).".

76. Section 126 amended (calculation of risk-weighted amount of exposures taking into account credit risk mitigation effect of recognized collateral)

(1) Section 126(2)(a)—

Repeal

"125(a)"

Substitute

"125(1)(a)".

(2) Section 126—

Repeal subsection (4)

Substitute

"(4) An authorized institution must—

(a) if the recognized collateral is not a securitization issue, determine the risk-weight to be allocated to the collateral in accordance with sections 109, 110, 111, 112, 113, 114, 115 and 116 as if the collateral were an on-balance sheet exposure; and

(b) if the recognized collateral is a securitization issue, determine the risk-weight to be allocated to the collateral in accordance with sections 237, 238 and 239 as if the collateral were an on-balance sheet exposure.".

77. Section 129 amended (calculation of risk-weighted amount of OTC derivative transactions and credit derivative contracts)

Section 129(1)—

Repeal paragraphs (a) to (d)

Substitute

"(a) dividing the outstanding default risk exposure of the transaction, net of specific provisions, into—

(i) the credit protection covered portion; and

(ii) the credit protection uncovered portion;

(b) multiplying the credit protection covered portion by the risk-weight attributable to the recognized collateral and multiplying the credit protection uncovered portion by the risk-weight attributable to the exposure; and

(c) adding together the 2 products derived from the application of paragraph (b).".

78. Section 130A added

After section 130—

Add

"**130A. Application of section 131**

Where an authorized institution uses the IMM(CCR) approach to calculate the default risk exposure of a netting set that contains OTC derivative transactions or credit derivative contracts—

(a) subject to paragraph (b), the institution must take into account the effect of any recognized netting in the manner set out in Part 6A instead of in the manner set out in section 131;

(b) paragraph (a) does not apply in the case of OTC derivative transactions or credit derivative contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.".

79. Section 131 amended (netting of OTC derivative transactions and netting of credit derivative contracts booked in trading book)

(1) Section 131, heading—

Repeal

"**booked in trading book**".

(2) Section 131(5), definition of ***derivative transaction***, paragraph (b)—

Repeal

"booked in the trading book".

80. Section 134 amended (capital treatment of recognized guarantees and recognized credit derivative contracts)

Section 134—

Repeal subsection (6)

Substitute

"(6) Where the credit protection covered portion of an authorized institution's exposure is such credit protection covered portion by virtue of a recognized guarantee (***original guarantee***) and is the subject of a counter-guarantee given by a sovereign, the institution may, in respect of the credit protection covered portion, treat the counter-guarantee as if it were the original guarantee if—

(a) the counter-guarantee covers all credit risk elements of the exposure to the extent that it relates to the credit protection covered portion;

(b) the counter-guarantee is given in such terms that it can be called if—

(i) for any reason the obligor in respect of the exposure to which the original guarantee relates fails to make payments due in respect of the exposure; and

(ii) the original guarantee could be called;

(c) the original guarantee and the counter-guarantee meet all of the requirements for guarantees set out in section 132 (except that the counter-guarantee need not meet the requirements set out in section 132(b) and (c)); and

(d) the institution reasonably considers the cover of the counter-guarantee to be adequate and effective and there is no evidence to suggest that the coverage of the counter-guarantee is less effective than that of a direct and explicit guarantee by the sovereign that gives the counter-guarantee.".

81. Section 135 amended (provisions supplementary to section 134)

(1) Section 135(2)—

Repeal

"deduct the first loss portion from its core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1250% to the first loss portion".

(2) Section 135(8)(c)—

Repeal

"deduct from the institution's core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1250% to".

82. Section 137 amended (maturity mismatches)

Section 137(3)—

Repeal

"125(a)"

Substitute

"125(1)(a)".

83. Section 139 amended (interpretation of Part 6)

(1) Section 139, definition of ***cash items***, paragraph (i)(i)—

Repeal

"a non-delivery-versus-payment basis"

Substitute

"a basis other than a delivery-versus-payment basis".

(2) Section 139(1), definition of ***cash items***, after paragraph (i)—

Add

"(j) the amounts of payment made or the current market value of the thing delivered, and the positive current exposure incurred, by the institution under transactions in securities (other than repo-style transactions), or transactions in foreign exchange or commodities, that—

(i) are entered into on a basis other than a delivery-versus-payment basis; and

(ii) have remained unsettled after the contractual date of payment or delivery to the institution for 5 or more business days;".

(3) Section 139(1), definition of ***credit equivalent amount***—

Repeal paragraph (b)

Substitute

"(b) in the case of an exposure in respect of an OTC derivative transaction or credit derivative contract, using the current exposure method;".

(4) Section 139(1)—

Repeal the definition of *eligible provisions*

Substitute

"***eligible provisions*** ( ), in relation to an authorized institution, means the sum of—

(a) the institution's specific provisions, partial write-offs, regulatory reserve for general banking risks and collective provisions attributed to non-securitization exposures that are subject to the IRB approach; and

(b) any discounts falling within section 163(3) or 164(5) on exposures referred to in paragraph (a) that are in default,

exclusive of any CVA and CVA loss;".

(5) Section 139(1)—

Repeal the definition of *expected loss amount*

Substitute

"***expected loss amount*** ( ), in relation to an exposure of an authorized institution, means—

(a) subject to paragraph (b), the expected loss amount of the exposure calculated by multiplying the EL of the exposure by the EAD of the exposure;

(b) if the exposure is an off-balance sheet exposure arising from a netting set that consists of one or more than one OTC derivative transaction or credit derivative contract, the expected loss amount of the exposure calculated by multiplying the EL of the exposure by the outstanding default risk exposure of the netting set;".

(6) Section 139(1), definition of ***exposure at default***—

Repeal

"equivalent amount"

Substitute

"equivalent amount, default risk exposure or outstanding default risk exposure, as the case may be".

(7) Section 139(1), definition of ***principal amount***, after paragraph (b)(iv) —

Add

"(v) in the case of an exposure to a person arising from the person holding collateral posted by the institution in a manner that is not bankruptcy remote from the person, the fair value of the collateral;".

(8) Section 139(1), definition of ***recognized collateral***, paragraph (b)(ii)—

Repeal

"(e)"

Substitute

"(e), (ea)".

(9) Section 139(1)—

Repeal the definition of *recognized financial collateral*

Substitute

"***recognized financial collateral*** ( )—

(a) subject to paragraph (b), means any collateral that—

(i) falls within any description in section 80(1)(a), (b), (c) or (d); and

(ii) satisfies the requirements under section 77(a), (b), (c), (d), (e), (ea) and (f);

(b) does not include any collateral in the form of real property or in the form of debt securities that, if treated as an on-balance sheet exposure of an authorized institution, would fall within the definition of ***re-securitization exposure*** in section 2(1);".

(10) Section 139(1)—

Add in alphabetical order

"***SFT risk-weighted amount*** ( ), in relation to SFTs, means the sum of the default risk risk-weighted amounts for all counterparties to the SFTs where the default risk risk-weighted amount for each of the counterparties is calculated as the product of—

(a) the sum of default risk exposures across all SFTs with the counterparty calculated under section 202(1) or (3) or 209(3), as the case requires; and

(b) the applicable risk-weight determined under Part 6;".

84. Section 140 amended (calculation of risk-weighted amount of exposures)

Section 140—

Repeal subsection (1)

Substitute

"(1) Subject to subsection (2) and section 141, an authorized institution must calculate the risk-weighted amount of the institution's exposure to credit risk by aggregating the figures derived from the application of subsections (1A), (1B) and (1C).

(1A) Subject to subsections (1B) and (1C), the authorized institution must multiply the EAD of the exposure by the exposure's relevant risk-weight.

(1B) For an equity exposure in respect of which—

(a) the authorized institution uses the internal models method; and

(b) the relevant risk-weight set out in section 186(3)(a)(ii) does not apply,

the institution must multiply the potential loss of the equity exposure as calculated using the institution's internal models by 12.5 in accordance with section 186.

(1C) For a counterparty credit risk exposure in respect of OTC derivative transactions, credit derivative contracts or SFTs—

(a) the authorized institution must, if it has an IMM(CCR) approval and an approval to use the IMM approach to calculate specific risk for interest rate exposures, calculate the risk-weighted amount of the counterparty credit risk exposure as the sum of—

(i) the IMM(CCR) risk-weighted amount of the transactions or contracts concerned that are covered by the IMM(CCR) approval;

(ii) the CEM risk-weighted amount or SFT risk-weighted amount, as the case may be, of the transactions or contracts concerned that are not covered by the IMM(CCR) approval or that fall within section 10B(5) or (7); and

(iii) the CVA risk-weighted amount determined using the advanced CVA method, the standardized CVA method, or a combination of those 2 methods that is permitted under these Rules, as the case requires;

(b) the authorized institution must, if it has an IMM(CCR) approval but does not have an approval to use the IMM approach to calculate specific risk for interest rate exposures, calculate the risk-weighted amount of the counterparty credit risk exposure as the sum of—

(i) the IMM(CCR) risk-weighted amount of the transactions or contracts concerned that are covered by the IMM(CCR) approval;

(ii) the CEM risk-weighted amount or SFT risk-weighted amount, as the case may be, of the transactions or contracts concerned that are

not covered by the IMM(CCR) approval or that fall within section 10B(5) or (7); and

(iii) the CVA risk-weighted amount determined using the standardized CVA method;

(c) the authorized institution must, if it does not have an IMM(CCR) approval for any of its transactions or contracts, calculate the risk-weighted amount of the counterparty credit risk exposure as the sum of—

(i) the CEM risk-weighted amount;

(ii) the SFT risk-weighted amount; and

(iii) the CVA risk-weighted amount determined using the standardized CVA method.

(1D) For the purposes of subsection (1C), the authorized institution may, in the case of a default risk exposure in respect of long settlement transactions, determine the exposure's relevant risk-weight using the STC approach on a permanent basis.

(1E) For the purposes of subsection (1C)(a)(iii), (b)(iii) and (c)(iii), an authorized institution must treat the total amount of the CVA capital charge for its counterparties determined in accordance with Division 3 of Part 6A as the basis for determining the CVA risk-weighted amount of the institution, regardless of whether any of those counterparties falls within Part 6.".

85. Section 140A amended (calculation of exposure at default)

Section 140A(1)—

Repeal

"165, 166, 179, 180, 181, 182, 183, 195, 196, 197, 201 or 202,"

Substitute

"164A, 165, 166, 179, 180, 180A, 181, 182, 183, 195, 196, 197, 201 or 202, or Part 6A,".

86. Section 141 amended (exposures to be covered)

(1) Section 141—

Renumber the section as section 141(1).

(2) Section 141(1)(a)—

Repeal subparagraphs (i) and (ii)

Substitute

"(i) that under Division 4 of Part 3 are required to be deducted from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital;

(ii) that are subject to the requirements of Division 4 of Part 6A; or

(iii) that are subject to the requirements of Part 7; and".

(3) Section 141(1)—

Repeal paragraph (b)

Substitute

"(b) subject to subsection (2), all of the institution's exposures to counterparties—

(i) under OTC derivative transactions, credit derivative contracts or SFTs booked in its trading book; or

(ii) in respect of assets posted by the institution as collateral that are held by the counterparties in a manner that is not bankruptcy remote from the counterparties.".

(4) After section 141(1)—

Add

"(2) Subsection (1)(b) does not apply to exposures that are subject to—

(a) deduction from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital under Division 4 of Part 3; or

(b) the requirements of Division 4 of Part 6A.".

87. Section 145 amended (equity exposures)

Section 145(1)(b)(iv)—

Repeal

"section 38 for inclusion in the institution's core capital"

Substitute

"Division 2 of Part 3 for inclusion in the institution's CET1 capital or Additional Tier 1 capital".

88. Section 146 amended (other exposures)

(1) Section 146(2)(a)—

Repeal

"items; and"

Substitute

"items.".

(2) Section 146(2)—

Repeal paragraph (b).

89. Section 149 amended (default of obligor)

(1) Section 149(2)(a)(ii), English text—

Repeal

"consolidated"

Substitute

"consolidation".

(2) Section 149—

Repeal subsections (5A) and (5B)

Substitute

"(5A) Subject to subsections (5B) to (5D), an authorized institution must treat its exposures to all individual obligors in a connected group as being in default if—

(a) a default of an obligor (referred to in this subsection and subsection (5B) as ***defaulting obligor***) in the connected group has occurred; and

(b) the defaulting obligor has been rated substantially on the basis of the economic or financial interdependence between the members in the connected group in accordance with the institution's policy and practices referred to in section 154(d).

(5B) Subsection (5A) does not apply in respect of the authorized institution's exposures to all obligors in the connected group if—

(a) the default referred to in paragraph (a) of that subsection (referred to in this subsection as ***relevant default***) is a default to which subsection (2)(a) applies by virtue of—

(i) the fact that the relevant default is a retail exposure in respect of which the defaulting obligor is past due for more than 90 days in respect of any payment owing by the obligor to the institution in respect of that exposure; and

(ii) the fact that the defaulting obligor is not also past due for more than 90 days in respect of any payment owing by the obligor to the institution in respect of any other exposure that is not a retail exposure; and

(b) the institution has not, following the occurrence of the relevant default, exercised its discretion under subsection (2)(a)(ii) to treat all other outstanding credit obligations of the defaulting obligor to the institution (or to any member of the consolidation group of the institution) as being in default.

(5C) The authorized institution may disregard subsection (5A) in respect of the institution's exposures to any obligor in the connected group if that obligor has not been rated on the basis referred to in paragraph (b) of that subsection.

(5D) The authorized institution may disregard subsection (5A) in respect of the institution's exposures to any obligor in the connected group if the institution demonstrates, to the satisfaction of the Monetary Authority, that disregarding that subsection in respect of those exposures—

(a) is neither imprudent nor unreasonable; and

(b) will not materially prejudice the calculation of the institution's regulatory capital for credit risk.".

90. Section 153 amended (rating assignment horizon)

(1) Section 153(b), after "obligor;"—

Repeal

"and".

(2) Section 153(c)—

Repeal

"obligations."

Substitute

"obligations; and".

(3) After section 153(c)—

Add

"(d) when estimating the PD for an obligor that is highly leveraged or whose assets are predominantly traded assets, ensure such estimate reflects the performance of the obligor's assets based on volatilities calibrated to data from periods of significant financial stress.".

91. Section 154 amended (rating coverage)

(1) Section 154—

Repeal paragraph (c)

Substitute

"(c) subject to paragraphs (d) and (e), rate on an individual basis each legal entity to which the institution is exposed;".

(2) Section 154(d)(iii)—

Repeal

"manner."

Substitute

"manner; and".

(3) After section 154(d)—

Add

"(e) have set out in policies and put into operation a process for the identification of specific wrong-way risk for each legal entity to which the institution is exposed.".

92. Section 156 amended (calculation of risk-weighted amount of corporate, sovereign and bank exposures)

(1) Section 156(2)—

Repeal

"subsection (5)"

Substitute

"subsections (5) and (5A)".

(2) After section 156(5)—

Add

"(5A) Where an exposure falls within section 140(1D), an authorized institution may calculate the risk-weighted amount of the exposure by multiplying the EAD of the exposure by the relevant risk-weight attributable to that exposure determined under Part 4.".

(3) After section 156(8)—

Add

"(9) Where an authorized institution that uses the advanced CVA method to calculate its CVA capital charge demonstrates to the satisfaction of the Monetary Authority that its VaR model used in the advanced CVA method covers the effects of rating migrations, the institution may—

(a) calculate the risk-weight applicable to a default risk exposure in respect of OTC derivative transactions or credit derivative contracts under subsection (2) with the full maturity adjustment set equal to 1; and

(b) calculate the risk-weight applicable to a default risk exposure in respect of OTC derivative transactions or credit derivative contracts under

subsection (5) with the full maturity adjustment set equal to 1 but the credit protection provider must be one of the counterparties covered by the CVA capital charge calculation.

(10) In subsection (9)—

full maturity adjustment ( ) means—

(a) that amount calculated by the component (1 - 1.5 x b)^ - 1 x (1 + (M - 2.5) x b) in Formula 16; or

(b) that amount calculated by the component $\frac{1+(M_{os}-2.5)\times b_{os}}{1-1.5\times b_{os}}$ in Formula 17,

as the case requires.".

93. Section 157A added

After section 157—

Add

"157A. Provisions supplementary to section 156(2) and (5)—asset value correlation multiplier for exposures to certain financial institutions or financial groups

(1) Subsection (2) applies to an obligor that is—

(a) a large regulated financial institution and (if it has any subsidiaries) its subsidiaries;

(b) a relevant member of a large regulated financial group; or

(c) an unregulated financial institution.

(2) Where a corporate, sovereign or bank exposure of an authorized institution is to an obligor to which this subsection applies, the institution must multiply the correlation (R) or correlation (ρ_{os}) in the risk-weight

function set out in Formula 16 or 17, as the case requires, by 1.25.

(3) An authorized institution must calculate all of the measures mentioned in the definition of ***substantial supervised entity*** in subsection (4) based on all available financial statements mentioned in that definition before the institution determines that a large regulated financial institution is not a substantial supervised entity.

(4) In this section—

large regulated financial group ( ) means a group, comprised of an ultimate holding company and all its subsidiaries, of which—

(a) a substantial supervised entity is a member; or

(b) at least one large regulated financial institution is a member if an authorized institution has not, for the purposes of subsection (1) as read with subsection (2), determined whether any member of the group is a substantial supervised entity;

large regulated financial institution ( ) means a supervised entity with total assets of not less than $780 billion as determined by reference to—

(a) the entity's most recent audited consolidated financial statements that include that entity in the consolidation; and

(b) the entity's most recent audited financial statements (if any);

relevant member ( ), in relation to a large regulated financial group—

(a) subject to paragraph (b), means a holding company, or a subsidiary of a holding company, that is a member of the group;

(b) does not include a large regulated financial institution that is a member of the group or (if such financial institution has any subsidiaries) its subsidiaries;

substantial supervised entity ( ), in relation to a group comprising an ultimate holding company and all of its subsidiaries, means a large regulated financial institution which is a member of the group and the total assets of which, the total annual revenue of which, or the total assets and total annual revenue of which, accounts for not less than 50% of the total assets of the group, the total annual revenue of the group, or the total assets and total annual revenue of the group, as the case may be, as determined by reference to—

(a) in the case of the numerator for the calculation of each of those measures—

(i) the most recent audited consolidated financial statements of the large regulated financial institution which include that institution in the consolidation; and

(ii) the most recent audited financial statements of the large regulated financial institution (if any); and

(b) in the case of the denominator for the calculation of each of those measures, the most recent audited consolidated financial statements of the group that include all the holding companies in the group and all the subsidiaries of those holding companies;

supervised entity ( ) means an entity that is supervised by a financial regulator that imposes prudential requirements (including prudential requirements relating

to capital adequacy, liquidity or solvency) that are consistent with international standards;

unregulated financial institution ( )—

(a) subject to paragraph (b), means an entity the main business of which is—

(i) management of financial assets;

(ii) lending;

(iii) factoring;

(iv) financial leasing;

(v) provision of credit enhancement;

(vi) securitization;

(vii) investment;

(viii) financial custody;

(ix) central counterparty services;

(x) proprietary trading;

(xi) any other financial services activity as specified in Part 11 of Schedule 1; or

(xii) any combination of 2 or more of the businesses falling within any of subparagraphs (i) to (xi);

(b) does not include a supervised entity or a relevant member of a large regulated financial group.".

94. Section 158 amended (provisions supplementary to section 156—risk-weights for specialized lending)

(1) Section 158(1), after "small-and-medium sized corporates"—

Add

"or section 157A in respect of exposures to large regulated financial institutions and (if they have any subsidiaries) their subsidiaries, relevant members of a large regulated financial group or unregulated financial institutions, as the case requires".

(2) Section 158(2)(c)(i)—

Repeal

"on Banking Supervision".

(3) After section 158(3)—

Add

"(4) The words and expressions used in this section and defined in section 157A(4) have the same meaning as in that section.".

95. Section 160 amended (loss given default under foundation IRB approach)

(1) Section 160(1)(a)—

Repeal

"use"

Substitute

"subject to paragraphs (c) and (d), use".

(2) Section 160(1)(a)(ii)—

Repeal

"and".

(3) Section 160(1)(b)—

Repeal

"use"

Substitute

"subject to paragraphs (c) and (d), use".

(4) Section 160(1)(b)—

Repeal

"exposures."

Substitute

"exposures;".

(5) After section 160(1)(b)—

Add

"(c) use 100% for the LGD of its default risk exposures in respect of single-name credit default swaps if—

(i) the swaps fall within section 226J(1); and

(ii) those exposures are determined in accordance with section 226J(3); and

(d) for transactions that fall within section 226J(4), use 100% for the LGD of the institution's default risk exposures in respect of the transactions if—

(i) the institution has the Monetary Authority's approval to calculate incremental risk charge for the transactions; and

(ii) the determination of the default risk exposures under that section has used existing calculations for incremental risk charge that already contain an LGD assumption.".

(6) Section 160(3), Formula 18, component LGD—

Repeal

"45% for the LGD of a senior exposure"

Substitute

"LGD specified in subsection (1)(a), (c) or (d), as the case may be,".

(7) Section 160(4)(a)—

Repeal

"of 45% specified in subsection (1)(a)"

Substitute

"specified in subsection (1)(a), (c) or (d), as the case may be".

(8) Section 160(4)(c)(iii)—

Repeal

"of 45% specified in subsection (1)(a)"

Substitute

"specified in subsection (1)(a), (c) or (d), as the case may be".

(9) Section 160(4)(e)—

Repeal

"of 45% specified in subsection (1)(a)"

Substitute

"specified in subsection (1)(a), (c) or (d), as the case may be".

96. Section 161 amended (loss given default under advanced IRB approach)

(1) Section 161(1)—

Repeal

"An"

Substitute

"Subject to subsections (2) and (3), an".

(2) Section 161(2)—

Repeal

"For the purposes of subsection (1), an"

Substitute

"An".

(3) After section 161(2)—

Add

"(3) An authorized institution that uses the advanced IRB approach must comply with section 160(1)(c) or (d), as the case requires, in estimating the LGD of a facility type that comprises default risk exposures in respect of—

(a) single-name credit default swaps that fall within the description in section 160(1)(c)(i) and (ii); or

(b) transactions that fall within the description in section 160(1)(d)(i) and (ii),

as if the institution were an authorized institution that uses the foundation IRB approach.".

97. Section 163 amended (exposure at default under foundation IRB approach—on-balance sheet exposures and off-balance sheet exposures other than OTC derivative transactions and credit derivative contracts)

Section 163(1)(a)(i)—

Repeal

"core capital"

Substitute

"CET1 capital".

98. Section 164 amended (exposure at default under advanced IRB approach—on-balance sheet exposures and off-balance sheet

exposures other than OTC derivative transactions and credit derivative contracts)

Section 164(1)(a)(ii)(A)—

Repeal

"core capital"

Substitute

"CET1 capital".

99. Section 164A added

After section 164—

Add

"**164A. Application of sections 165 and 166(b) and (c)**

Sections 165 and 166(b) and (c) do not apply to OTC derivative transactions or credit derivative contracts for which an authorized institution has an IMM(CCR) approval except for transactions or contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.".

100. Section 168 amended (maturity under advanced IRB approach)

(1) Section 168(1)(a)(ii)—

Repeal

"(b)"

Substitute

"(b), (ba), (bb)".

(2) Section 168(1)(b)—

Repeal

"paragraph (c)"

Substitute

"paragraphs (ba), (bb) and (c)".

(3) After section 168(1)(b)—

Add

"(ba) if the exposure is a default risk exposure in respect of a netting set calculated using the IMM(CCR) approach and the original maturity of the longest-dated contract contained in the netting set is greater than one year, the M of the exposure is calculated by the use of Formula 20A instead of Formula 20;

(bb) subject to paragraph (c)—

(i) if the exposure is a default risk exposure in respect of a netting set calculated using the IMM(CCR) approach and all the transactions in the netting set have an original maturity of not more than one year—

(A) the effective maturity of each transaction in the netting set is calculated by the use of Formula 20; and

(B) the effective maturity of the netting set is calculated as the weighted average effective maturity of the transactions (using the notional amount of each transaction for weighting the maturity of the transactions within the netting set); and

(ii) if the netting set referred to in subparagraph (i) contains only one transaction, Formula 20 is used to calculate the M of the exposure;".

(4) Section 168(1)(c), after "paragraph (b)"—

Add

"or (bb)".

(5) Section 168(1)(d)—

Repeal

"if the exposure"

Substitute

"subject to paragraphs (ba) and (bb), if the exposure".

(6) Section 168(1)(d), after "the M"—

Add

"but the M must be not less than one year".

(7) Section 168(1), after Formula 20—

Add

"**Formula 20A**

Formula to be Used Instead of Formula 20 where Section 168(1)(ba) is Applicable

$$M = \frac{\sum_{k=1}^{t_k \le 1 year} \text{Effective EE}_k \times \Delta t_k \times df_k + \sum_{t_k > 1 year}^{maturity} EE_k \times \Delta t_k \times df_k}{\sum_{k=1}^{t_k \le 1 year} \text{Effective EE}_k \times \Delta t_k \times df_k}$$

where—

(a) df_k is the risk-free discount factor for future time period t_k;

(b) Effective EE_k = effective EE at time t_k calculated in accordance with section 226G;

(c) Maturity = the time when the transaction that has the longest residual maturity in the netting set matures; and

(d) $\Delta t_k = t_k - t_{k-1}$ is the time interval between t_k and t_{k-1} when EE is calculated at dates that are not equally spaced over time.".

(8) Section 168—

Repeal subsection (4)

Substitute

"(4) Where an exposure of an authorized institution falls within paragraph (ab) of the definition of ***relevant short-term exposure*** in subsection (5)—

(a) subject to paragraphs (b) and (c), the institution must calculate the M of the exposure in accordance with subsection (1)(d);

(b) subject to paragraph (c), if the exposure is a default risk exposure calculated using the IMM(CCR) approach, the institution must calculate the M in accordance with subsection (1)(bb); and

(c) in determining the M, the institution must apply a minimum level of M equal to—

(i) 10 days for a netting set that contains OTC derivative transactions, credit derivative contracts or margin lending transactions;

(ii) 5 days for a netting set that contains repo-style transactions; and

(iii) 10 days for a netting set that contains transactions or contracts that fall within both subparagraphs (i) and (ii).".

(9) Section 168(5), definition of ***relevant short-term exposure***, paragraph (a)—

Repeal

"transaction or securities margin lending transaction"

Substitute

"transaction, credit derivative contract or margin lending transaction".

(10) Section 168(5), definition of ***relevant short-term exposure***, after paragraph (a)—

Add

"(ab) means an exposure in respect of a netting set in respect of which all the transactions or contracts fall within the descriptions in paragraph (a);".

(11) Section 168(5), definition of ***relevant short-term exposure***, paragraph (b)(ii)—

Repeal

"non-delivery-versus-payment transaction"

Substitute

"transaction that is entered into on a basis other than a delivery-versus-payment basis".

101. Section 180A added

After section 180—

Add

"**180A. Application of sections 181 and 182(b) and (c)**

Sections 181 and 182(b) and (c) do not apply to OTC derivative transactions or credit derivative contracts for which an authorized institution has an IMM(CCR) approval except for transactions or contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.".

102. Section 182 amended (exposure at default—other off-balance sheet exposures not specified in Table 11 or 20)

Section 182, Chinese text—

Repeal

everything after "EAD 的目的，"

Substitute

"計算該風險承擔的信貸等值數額如下—

(a) 除(c)段另有規定外，如表 20 沒有指明該承擔，而該承擔不屬場外衍生工具交易或信用衍生工具合約，應用 100% CCF，並按照在作出所有必需的變通後的第 180 條的規定；

(b) 除(c)段另有規定外，如該承擔屬表 11 沒有指明的場外衍生工具交易或信用衍生工具合約，將該承擔視為屬表 11 第 5 項所指者，應用該項目指明的有關 CCF，並按照在作出所有必需的變通後的第 181 條的規定；或

(c) 應用依據附表 1 第 2 部適用於該承擔的 CCF，並按照在作出所有必需的變通後的第 180 或 181(視情況所需而定)條的規定。".

103. Section 183 amended (equity exposures—general)

(1) Section 183(1)—

Repeal

"subsection (2),"

Substitute

"subsections (2), (5), (6), (7) and (8),".

(2) After section 183(4)—

Add

"(5) Subsection (6) applies to—

(a) an authorized institution's holdings of shares in any commercial entity if the holdings amount to more than 10% of the ordinary shares issued by that commercial entity; and

(b) an authorized institution's holdings of shares in any commercial entity if that commercial entity is an affiliate of the institution.

(6) Subject to section 43(1)(n), where the net book value of an authorized institution's holdings mentioned in subsection (5)(a) or (b) exceeds 15% of its capital base as reported in its capital adequacy ratio return as at the immediately preceding calendar quarter end date, the institution must allocate a risk-weight of 1250% to that amount of the net book value of the holdings that exceeds that 15% in the calculation of the risk-weighted amount of that portion of the equity exposure.

(7) Where an authorized institution uses the PD/LGD approach to calculate its credit risk in respect of equity exposures, the institution must allocate a risk weight of 1250% to the EL amount of such exposures as calculated in accordance with section 223, and add the product of the two items to the risk-weighted amount of the institution's equity exposures.

(8) An authorized institution must calculate the risk-weighted amount of an equity exposure to a financial sector entity that is a significant capital investment by multiplying that portion of the EAD of the equity exposure that is not subject to deduction from the institution's CET1 capital under section 43(1)(p) by a risk-weight of 250%."

104. Section 191 amended (PD/LGD approach—rating assignment horizon)

(1) Section 191(b)—

Repeal

"obligor; and"

Substitute

"obligor;".

(2) Section 191(c)—

Repeal

"obligations."

Substitute

"obligations; and".

(3) After section 191(c)—

Add

"(d) when estimating the PD for an obligor that is highly leveraged or whose assets are predominantly traded assets, ensure such estimate reflects the performance of the obligor's assets based on volatilities calibrated to data from periods of significant financial stress.".

105. Section 194 amended (PD/LGD approach—calculation of risk-weighted amount of equity exposures)

(1) Section 194(1)—

Repeal

"158, 159, 160, 161, 162, 163, 164,"

Add

"157A, 158, 159, 160, 161, 162, 163, 164, 164A,".

(2) Section 194(1)(b)(i), after "corporates"—

Add

"or section 157A in respect of exposures to large regulated financial institutions and (if they have any subsidiaries) their subsidiaries, relevant members of a large regulated financial group or unregulated financial institutions, as the case requires".

(3) Section 194(1)—

Repeal paragraph (g)

Substitute

"(g) if the risk-weight calculated in accordance with paragraphs (a), (b), (c) and (d) for an equity exposure of the institution plus the EL associated with the equity exposure multiplied by 12.5 exceeds 1250%, the institution must allocate a risk-weight of 1250% in the calculation of the risk-weighted amount of the equity exposure; and".

(4) After section 194(1)—

Add

"(1A) The words and expressions used in this section and defined in section 157A(4) have the same meaning as in that section.".

106. Section 195 amended (cash items)

Section 195(1), Table 21—

Add

"5.	Cash items that fall within paragraph (j) of the definition of ***cash items*** in section 139(1)	1250%".

107. Section 202 substituted

Section 202—

Repeal the section

Substitute

"**202. Securities financing transactions**

(1) Where an authorized institution does not have an IMM(CCR) approval for SFTs, the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) in accordance with subsection (6) and section 76A(4) to (7), and calculate the risk-weighted amount of its exposures to the assets underlying the SFTs in accordance with subsections (4) and (5) and sections 75 and 76.

(2) Subject to subsections (3), (4), (5) and (6), an authorized institution that has an IMM(CCR) approval for SFTs must apply sections 75, 76 and 76A(2) to all its SFTs.

(3) Where—

(a) an authorized institution has an IMM(CCR) approval for SFTs but the approval does not include SFTs that are long settlement transactions; or

(b) an authorized institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods mentioned in section 10A(1)(b) for certain SFTs,

the institution must calculate the risk-weighted amount of its default risk exposures in respect of SFTs (whether booked in its banking book or trading book) that are not, by virtue of the circumstance mentioned in paragraph (a) or (b), subject to the IMM(CCR) approach, in accordance with subsection (6) and section 76A(4) to (7), and calculate the risk-weighted amount of its

exposures to the assets underlying the SFTs in accordance with subsections (4) and (5) and sections 75 and 76.

(4) Where an authorized institution applies section 75 to an SFT booked in its banking book, the institution must determine the risk-weight to be allocated to its exposure under the SFT in accordance with—

(a) the risk-weight function for corporate, sovereign and bank exposures;

(b) the risk-weight function for retail exposures; or

(c) the market-based approach or the PD/LGD approach for equity exposures,

as the case may be, according to the nature of the asset underlying the SFT, and, where applicable, the IRB class within which the issuer of the assets falls.

(5) Where an authorized institution applies section 76 to an SFT booked in its trading book, the institution must determine the risk-weight to be allocated to its exposure under the SFT by reference to Part 8.

(6) Where an authorized institution applies section 76A(2) or 76A(4) to (7), as the case requires, to an SFT, the institution must determine the risk-weight to be allocated to its exposure under the SFT in accordance with—

(a) the risk-weight function for corporate, sovereign and bank exposures; or

(b) the risk-weight function for retail exposures,

as the case may be, according to the IRB class within which an exposure to the counterparty to the SFT falls and, where applicable, in accordance with the treatment of credit risk mitigation set out in Division 10.".

108. Section 203 amended (credit risk mitigation—general)

(1) Section 203(1)—

Repeal

"An"

Substitute

"Subject to subsections (1A) and (1B), an".

(2) After section 203(1)—

Add

"(1A) An authorized institution must not take into account the effect of recognized credit risk mitigation in calculating the risk-weighted amount of its exposures in accordance with this Division to the extent that the credit risk mitigating effect concerned has already been taken into account in the institution's estimates of any of the credit risk components of the applicable risk-weight function in accordance with these Rules other than this Division.

(1B) Where an authorized institution has bought credit protection for an exposure and the credit protection is in the form of a single-name credit default swap that falls within section 226J(1), the institution must not take into account the credit risk mitigating effect of that swap when calculating the risk-weighted amount of the exposure.".

109. Section 209 amended (recognized netting)

(1) Section 209(1)—

Repeal

"For"

Substitute

"Subject to subsections (3A) and (3B), for".

(2) Section 209(2)—

Repeal

"subsection (4)"

Substitute

"subsections (3A) and (4)".

(3) Section 209(2)(b)—

Repeal

"booked in the institution's trading book".

(4) Section 209(3)—

Repeal

"Where"

Substitute

"Subject to subsection (3B), where".

(5) After section 209(3)—

Add

"(3A) Where an authorized institution uses the IMM(CCR) approach to calculate the EAD of a netting set that contains OTC derivative transactions or credit derivative contracts, the institution must take into account the effect of any recognized netting in respect of OTC derivative transactions or credit derivative contracts in the manner set out in Part 6A instead of in the manner set out in subsections (1) and (2) except for transactions or contracts for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the current exposure method.

(3B) Where an authorized institution uses the IMM(CCR) approach to calculate the EAD of a netting set that contains SFTs, the institution must take into account the

effect of any recognized netting in respect of repo-style transactions in the manner set out in Part 6A instead of in the manner set out in subsections (1) and (3) except for transactions for which the institution is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods mentioned in section 10A(1)(b).".

110. Section 211 amended (recognized guarantees and recognized credit derivative contracts under substitution framework for corporate, sovereign and bank exposures under foundation IRB approach and for equity exposures under PD/LGD approach)

Section 211—

Repeal subsection (2)

Substitute

"(2) For the purposes of subsection (1), sections 98(a)(vi) and 99(1)(b)(vi) are deemed to read as—

"(vi) a corporate that—

(A) has an ECAI issuer rating; or

(B) has an exposure that is assessed under the institution's rating system and is assigned to an obligor grade with an estimate of PD;".

111. Section 216 amended (provisions supplementary to section 214(1)—substitution framework for corporate, sovereign and bank exposures under foundation IRB approach and for equity exposures under PD/LGD approach)

(1) Section 216(1), after "subsections (2), (3),"—

Add

"(3A),".

(2) Section 216(2)(a)—

Repeal

"subsection (3)"

Substitute

"subsections (3) and (3A)".

(3) After section 216(3)—

Add

"(3A) Where the credit protection covered portion of an authorized institution's exposure is such credit protection covered portion by virtue of a recognized guarantee (***original guarantee***) and is the subject of a counter-guarantee given by a sovereign, the institution may, in respect of the credit protection covered portion, treat the counter-guarantee as if it were the original guarantee if—

(a) the counter-guarantee covers all credit risk elements of the exposure to the extent that it relates to the credit protection covered portion;

(b) the counter-guarantee is given in such terms that it can be called if—

(i) for any reason the obligor in respect of the exposure to which the original guarantee relates fails to make payments due in respect of the exposure; and

(ii) the original guarantee could be called;

(c) the original guarantee and the counter-guarantee meet all of the requirements for guarantees set out in section 98 (except that the counter-guarantee need not meet the requirements set out in section 98(b) and (c)); and

(d) the institution reasonably considers the cover of the counter-guarantee to be adequate and effective and there is no evidence to suggest that the coverage of the counter-guarantee is less effective than that of a direct and explicit guarantee by the sovereign that gives the counter-guarantee.".

112. Section 217 amended (provisions supplementary to section 214(1)—substitution framework for corporate, sovereign and bank exposures under advanced IRB approach and for retail exposures under retail IRB approach)

(1) Section 217(2)—

Repeal

"subsection (3)"

Substitute

"subsections (3) and (4)".

(2) Section 217(2)(a)—

Repeal

"and subsection (3)".

(3) After section 217(3)—

Add

"(4) Where the credit protection covered portion of an authorized institution's exposure is such credit protection covered portion by virtue of a recognized guarantee (***original guarantee***) and is the subject of a counter-guarantee given by a sovereign, the institution may, in respect of the credit protection covered portion, treat the counter-guarantee as if it were the original guarantee if—

(a) the counter-guarantee covers all credit risk elements of the exposure to the extent that it relates to the credit protection covered portion;

(b) the counter-guarantee is given in such terms that it can be called if—

(i) for any reason the obligor in respect of the exposure to which the original guarantee relates fails to make payments due in respect of the exposure; and

(ii) the original guarantee could be called;

(c) the original guarantee and the counter-guarantee meet all of the requirements for guarantees set out in section 98 (except that the counter-guarantee need not meet the requirements set out in section 98(b) and (c)); and

(d) the institution reasonably considers the cover of the counter-guarantee to be adequate and effective and there is no evidence to suggest that the coverage of the counter-guarantee is less effective than that of a direct and explicit guarantee by the sovereign that gives the counter-guarantee.".

113. Section 220 amended (calculation of expected losses and eligible provisions for corporate, sovereign, bank and retail exposures)

(1) Section 220(1)(b)—

Repeal

"core capital and supplementary capital in accordance with section 48(2)(b)"

Substitute

"CET1 capital in accordance with section 43(1)(i)".

(2) Section 220(1)(c)—

Repeal

"45(3)"

Substitute

"42(3)(c)".

(3) Section 220(1)(c)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

114. Section 221 amended (determination of eligible provisions for calculation of total eligible provisions)

Repeal

"45(2)"

Substitute

"42(2)".

115. Section 223 amended (equity exposures—PD/LGD approach)

(1) Section 223(1)—

Repeal

"deduct from its core capital and supplementary capital the EL amount of the equity exposures in accordance with section 48(2)(i)"

Substitute

"allocate a risk-weight of 1250% to the EL amount of the equity exposures".

(2) Section 223(2)(b)—

Repeal

"maximum risk-weight set out in section 194(1)(g)(i)"

Substitute

"risk-weight set out in section 194(1)(g)".

(3) Section 223(2)(b), after "zero;"—

Add

"and".

(4) Section 223(2)—

Repeal paragraph (c).

116. Section 224 amended (application of scaling factor)

(1) Section 224—

Renumber the section as section 224(1).

(2) Section 224(1)—

Repeal

"An"

Substitute

"Subject to subsection (2), an".

(3) After section 224(1)—

Add

"(2) Subsection (1) does not apply to CVA risk-weighted amount.".

117. Section 226 amended (calculation of capital floor)

(1) Section 226(5)(a)(i)—

Repeal

"and".

(2) Section 226(5)(a)(ii)—

Repeal

"exposures;"

Substitute

"exposures; and".

(3) After section 226(5)(a)(ii)—

Add

"(iii) the methodologies prescribed under Division 4 of Part 6A for exposures to CCPs;".

(4) Section 226(5)(e)(i)—

Repeal

"core capital and supplementary capital"

Substitute

"CET1 capital, Additional Tier 1 capital and Tier 2 capital".

(5) Section 226(5)(e)(ii)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

(6) After section 226(5)—

Add

"(5A) For the purposes of subsection (5)(a)(i), an authorized institution must treat the total amount of the CVA capital charge for its counterparties determined in accordance with Division 3 of Part 6A as the basis for determining the CVA risk-weighted amount of the institution under section 52(3)(a) and (3A), regardless of whether any of those counterparties falls within Part 4.".

(7) Section 226(7)(e)(i)—

Repeal

"supplementary capital under section 45(3)"

Substitute

"Tier 2 capital under section 42(3)".

(8) Section 226(7)(e)(i)—

Repeal

"supplementary capital under section 48(2)(b)"

Substitute

"CET1 capital under section 43(1)(i)".

(9) Section 226(7)(e)(ii)—

Repeal

"core capital and supplementary capital"

Substitute

"CET1 capital, Additional Tier 1 capital and Tier 2 capital".

(10) Section 226(7)(e)(iii)—

Repeal

"supplementary capital"

Substitute

"Tier 2 capital".

118. Part 6A added

After Part 6—

Add

"Part 6A

Calculation of Counterparty Credit Risk

Division 1—General

226A. Interpretation of Part 6A

In this Part—

cross-product net amount ( ), in relation to any bilateral master agreements or transactions covered by a valid cross-product netting agreement, means a net sum of—

(a) the positive and negative close-out values of the individual bilateral master agreements; and

(b) the positive and negative mark-to-market values of the individual transactions;

current exposure ( ), in relation to the use of the IMM(CCR) approach and a netting set with a counterparty, means the larger of—

(a) zero; or

(b) the market value of the transaction or transactions within the netting set that would be lost upon the default of the counterparty (but assuming no recovery on the value of that transaction or those transactions, as the case may be, in bankruptcy);

CVA risk ( ), in relation to a transaction with a counterparty, means the risk of mark-to-market losses in the transaction arising from a change in the CVA for the counterparty;

EE means expected exposure;

effective EE ( ) means effective expected exposure;

effective expected exposure ( ), in relation to a netting set, means the amount calculated in accordance with section 226G;

eligible CVA hedge ( ) means a hedge that falls within section 226T(1);

expected exposure ( ), in relation to a netting set, means the amount calculated in accordance with section 226H;

margin agreement ( ) means a contractual agreement or provisions to an agreement under which one counterparty must supply collateral to a second counterparty when an exposure of that second counterparty to the first counterparty exceeds a specified level;

margin period of risk ( ) means the time period from the last exchange of collateral covering a netting set with a defaulter until the netting set is closed out and the resulting market risk is re-hedged;

margin threshold ( ), in relation to a margin agreement, means the maximum amount of unsecured exposure above which one of the parties to the agreement has the right to call for collateral;

minimum transfer amount ( ), in relation to a margin agreement, means an amount below which no transfer of collateral is made;

payment transaction ( ) means a transaction that executes a payment or fund transfer;

single-name contingent credit default swap ( ) means a single-name credit default swap the notional

amount of which is referenced to the mark-to-market value of a transaction specified in the swap;

specific wrong-way risk ( ) means the risk that arises when the exposure to a counterparty is positively correlated with the probability of default of the counterparty due to the nature of the transactions with the counterparty;

spot transaction ( ) means a single outright transaction involving the delivery of a security, commodity, foreign currency (including gold) or any other financial instrument against cash within a period that is regarded as an immediate delivery under the market standard for that particular security, commodity, currency or financial instrument at the current market price on the date of the transaction;

spread gamma ( ), in relation to the calculation of the CVA in respect of a counterparty, means a measure of the rate of change in delta to changes in the credit spread of the counterparty, where delta is the ratio of the change in the CVA to the change in the credit spread.

226B. Valid cross-product netting agreement

(1) In this Part, a reference to a valid cross-product netting agreement is to be construed, in relation to an authorized institution's transactions with a counterparty that are covered by an IMM(CCR) approval, as an agreement (***netting arrangement***) in respect of which the conditions set out in subsection (2) are met.

(2) The conditions are—

(a) the netting arrangement—

(i) is in writing;

(ii) is bilateral between the institution and the counterparty;

(iii) permits netting across transactions of different product categories;

(iv) creates a single legal obligation for all individual bilateral master agreements and individual transactions covered by the netting arrangement; and

(v) provides, in effect, that the institution would have a single claim or obligation to receive or pay only the cross-product net amount, in the event that the counterparty to the netting arrangement, or a counterparty to whom the netting arrangement has been validly assigned, fails to comply with any obligation under any of the bilateral master agreements or transactions due to default, insolvency, bankruptcy, or similar circumstance;

(b) the institution has been given written and reasoned legal advice that concludes with a high degree of certainty that, in the event of a challenge in a court of law or before an administrative authority, including a challenge resulting from default, insolvency, bankruptcy, or similar circumstance, the relevant court or administrative authority, as the case may be, would find the institution's exposure to be the cross-product 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 that governs the individual transactions and bilateral master agreements covered by the netting arrangement; and

(iii) the law that governs the netting arrangement;

(c) the legal advice mentioned in paragraph (b) addresses the validity and enforceability of the netting arrangement under its terms and the impact of the netting arrangement on the material provisions of any individual bilateral master agreement covered by the netting arrangement;

(d) the legal advice mentioned in paragraph (b)—

(i) is generally recognized by the legal community in Hong Kong; or

(ii) is a memorandum of law that addresses all relevant issues in a reasoned manner;

(e) the institution establishes and maintains procedures to verify that any transaction that is covered by the netting arrangement and to be included in a netting set is covered by legal advice described in paragraphs (b), (c) and (d);

(f) the institution establishes and maintains procedures to monitor developments in any law relevant to the netting arrangement in order to ensure that the netting arrangement continues to satisfy the conditions set out in this subsection applicable to it;

(g) the netting arrangement 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 the defaulter is a net creditor under the netting arrangement;

(h) each bilateral master agreement covered by the netting arrangement falls within the definition of ***valid bilateral netting agreement*** in section 2(1) and the credit risk mitigation for each transaction covered by the netting arrangement meets the applicable requirements for the recognition of credit risk mitigation set out in Part 4, 5 or 6, as the case may be;

(i) the institution maintains in its files documentation adequate to support the nettings under the netting arrangement;

(j) the institution measures and manages its aggregate credit exposure to the counterparty to the netting arrangement on a net basis; and

(k) the institution aggregates credit exposures to the counterparty to the netting arrangement to arrive at a single legal exposure across transactions covered by the netting arrangement and that aggregation is factored into credit limits and internal capital processes.

(3) For the purposes of subsection (2)—

(a) repo-style transactions;

(b) margin lending transactions; and

(c) derivative contracts,

are to be treated as different product categories.

Division 2—IMM(CCR) Approach

226C. Application of Division 2

(1) This Division applies to an authorized institution that has an IMM(CCR) approval for calculating the default risk exposures in respect of contracts or transactions falling within any one or more of the categories mentioned in section 10B(1)(a), (b) and (c).

(3) Unless otherwise expressly permitted by, and in accordance with, another provision of these Rules, an authorized institution must calculate its default risk exposures in respect of all the transactions (however described) that are covered by its IMM(CCR) approval in accordance with this Division.

226D. Calculation of IMM(CCR) risk-weighted amount at portfolio level under IMM(CCR) approach

(1) An authorized institution must, for each of its counterparties—

(a) calculate the sum of its default risk exposures (and outstanding default risk exposures in the case of netting sets that contain OTC derivative transactions or credit derivative contracts) in respect of all the netting sets with the counterparty based on effective EPEs that are estimated using current market data, and multiply the sum so calculated by the risk-weight applicable to the counterparty to obtain the risk-weighted amount of the sum (***risk-weighted amount A***); and

(b) subject to subsection (3), calculate the sum of its default risk exposures (and outstanding default risk exposures in the case of netting sets that contain

OTC derivative transactions or credit derivative contracts) in respect of all the netting sets with the counterparty based on effective EPEs that are estimated using a stress calibration as set out in section 3(f) of Schedule 2A, and multiply the sum so calculated by the risk-weight applicable to the counterparty to obtain the risk-weighted amount of the sum (***risk-weighted amount B***).

(2) An authorized institution must, after completing the calculations required under subsection (1)—

(a) aggregate all of its counterparties' risk-weighted amount A;

(b) aggregate all of its counterparties' risk-weighted amount B; and

(c) determine the IMM(CCR) risk-weighted amount as the greater of the 2 aggregates.

(3) The calibration mentioned in subsection (1)(b) must be a single consistent stress calibration for the whole portfolio of counterparties concerned.

(4) For the purposes of subsection (1), an authorized institution that uses the BSC approach or the STC approach to calculate its credit risk for non-securitization exposures must risk-weight its default risk exposures and, if applicable, outstanding default risk exposures net of specific provisions.

226E. Calculation of default risk exposure at netting set level under IMM(CCR) approach

(1) Subject to subsection (2) and section 226J(3) and (4), an authorized institution must use Formula 23A to calculate the default risk exposure of a netting set.

Formula 23A

Calculation of Default Risk Exposure at Netting Set Level under IMM(CCR) Approach

default risk exposure = α x Effective EPE

where—

α	=	1.4; and
Effective EPE	=	effective EPE calculated in accordance with section 226F or 226L, as the case requires.

(2) Subject to subsection (3), the Monetary Authority may, by notice in writing given to an authorized institution, require the institution to use a higher α in Formula 23A based on the risk profile of the institution's counterparty credit risk exposures.

(3) Factors that the Monetary Authority may take into account for the purposes of deciding whether or not to give a notice under subsection (2) to an authorized institution include—

(a) the granularity of the institution's counterparties;

(b) the level of exposures to general wrong-way risk (being the risk that arises when the probability of default of counterparties is positively correlated with general market risk factors);

(c) the correlation of market values across the institution's counterparties; and

(d) other institution-specific characteristics of the institution's counterparty credit risk exposures.

(4) An authorized institution must comply with the requirements of a notice given to it under subsection (2).

226F. Calculation of Effective EPE

Subject to section 226K, an authorized institution must use Formula 23B to calculate the Effective EPE of a netting set.

Formula 23B

Calculation of Effective EPE of Netting Set

$$\text{Effective EPE} = \sum_{k=1}^{\min(1\,year,\,\text{maturity})} \text{Effective EE}_{t_k} \times \Delta t_k$$

where—

Effective EE_{t_k} = effective EE at time t_k calculated in accordance with section 226G;

Maturity = the time when the transaction that has the longest residual maturity in the netting set matures; and

Δt_k = $t_k - t_{k-1}$, which is the time interval between t_k and t_{k-1} when EE is calculated at dates that are not equally spaced over time.

226G. Calculation of Effective EE

(1) An authorized institution must use Formula 23C to calculate the effective EE at time t_k in respect of a netting set.

Formula 23C

Calculation of Effective EE at Time t_k in Respect of Netting Set

$$\text{Effective EE}_{t_k} = \max\left(\text{Effective EE}_{t_{k-1}}, \text{EE}_{t_k}\right)$$

where—

EE_{t_k} = EE at time t_k calculated in accordance with section 226H.

(2) In using Formula 23C—

(a) the current date is denoted as t_0; and

(b) $\text{Effective EE}_{t_0}$ equals current exposure.

226H. Calculation of EE

(1) An authorized institution must calculate the EE of a netting set at any particular future date (being a date before the transaction that has the longest residual maturity in the netting set matures) as the average of the distribution of exposures at that particular future date.

(2) An authorized institution must estimate the distribution of exposures at any particular future date by—

(a) estimating the probability distribution of the net market values of the transactions within the netting set at that future date, given the realized market value of those transactions up to the present time; and

(b) setting all negative net market values obtained in the estimation mentioned in paragraph (a) to zero.

(3) Subject to subsection (4), an authorized institution may, when estimating the probability distribution mentioned in subsection (2)(a), include any collateral—

(a) that falls within any description in section 80(1)(a), (b), (c) or (d); and

(b) that satisfies the requirements under section 77(a), (b), (c), (d), (e), (ea) and (f),

except collateral in the form of debt securities that, if treated as an on-balance sheet exposure of the institution, would fall within the definition of ***re-securitization exposure*** in section 2(1).

(4) Subsection (3) does not apply in the case of an authorized institution that has an IMM(CCR) approval that prohibits the institution from using that subsection.

226I. Treatments for certain credit derivative contracts

An authorized institution must treat the default risk exposure in respect of a credit derivative contract as zero if—

(a) the contract is a credit default swap in which the institution is the protection seller and regulatory capital calculated in accordance with Part 4, 5 or 6, as the case may be, has been provided for the institution's exposure to the credit risk of the reference obligation underlying the swap; or

(b) the institution is the protection buyer in the contract and the credit risk mitigation effect of the contract has been recognized and taken into account in accordance with Divisions 9 and 10 of Part 4, Divisions 7 and 8 of Part 5, Division 10 of Part 6, or Division 3, 5 or 6 of Part 7, for the purposes of the calculation of the risk-weighted amount of the exposure to which credit protection is provided by the contract.

226J. Treatments for transactions with specific wrong-way risk

(1) Where in respect of an authorized institution's transaction with a counterparty there is—

(a) a legal connection between the counterparty and the issuer of the assets underlying the transaction (or, where the transaction is a credit derivative contract, the reference entity specified in that contract); and

(b) specific wrong-way risk,

the institution must treat the transaction as a separate netting set from its other netting sets with the counterparty.

(2) For the purposes of subsection (1), a legal connection is considered to exist if the counterparty and the issuer (or the reference entity in the case of a credit derivative contract)—

(a) would constitute a single risk because one of them, directly or indirectly, has control over the other; or

(b) would be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other would be likely to encounter funding or repayment difficulties.

(3) An authorized institution must, if a single-name credit default swap falls within subsection (1), set the default risk exposure to the counterparty in respect of that swap as equal to the full expected loss in the remaining fair value of the reference obligations specified in that swap (being the amount determined after recognizing any market value that has already been lost and any expected

recoveries, assuming the reference entity concerned is in liquidation).

(4) An authorized institution must, if—

(a) a transaction is referenced to a single issuer;

(b) the transaction is not a single-name credit default swap; and

(c) the transaction falls within subsection (1),

set the default risk exposure to the counterparty in respect of that transaction as equal to the value of the transaction estimated under the assumption of a jump-to-default of the asset underlying the transaction.

226K. Treatments for margin agreements

(1) An authorized institution must, for a netting set that is subject to a margin agreement, determine the effective EPE in respect of the netting set by—

(a) using the effective EE calculated from Formula 23C without taking into account the margin agreement;

(b) if the netting set is subject to daily remargining and daily mark-to-market, using the shortcut method set out in section 226L; or

(c) subject to subsections (2) and (3), if the internal model used by the institution captures the effects of margin agreements when estimating EE, using the EE generated by the model directly in Formula 23C.

(2) Subsection (1)(c) does not apply in the case of an authorized institution that has an IMM(CCR) approval that prohibits the institution from using that paragraph.

(3) An authorized institution must not, for the purposes of subsection (1)(c), recognize, in its default risk exposure calculations for OTC derivative transactions, credit derivative contracts and SFTs, the effect of collateral that is not cash of the same currency as the default risk exposure unless—

(a) the institution models collateral jointly with the exposure in the calculations; or

(b) if the institution is not able to meet the requirement in paragraph (a), it applies standard supervisory haircuts (within the meaning of section 51(1)) to the collateral.

(4) An authorized institution must not capture the effect of a reduction of default risk exposure due to any clauses of a collateral agreement that require receipt of collateral when the credit quality of the counterparty concerned deteriorates.

226L. Shortcut method

(1) Under the shortcut method, the effective EPE to a counterparty with a margin agreement equals the lesser of—

(a) the effective EPE calculated without taking into account any collateral held or posted by the authorized institution as margins under the margin agreement, plus any collateral that has been posted by the institution to the counterparty as an independent amount or initial margin; or

(b) an add-on calculated in accordance with subsection (2), plus the larger of—

(i) the current exposure, net of all collateral currently held or posted by the authorized

institution but excluding any collateral called or in dispute; or

(ii) the largest net exposure, including all collateral held or posted by the authorized institution under the margin agreement, that would not trigger a collateral call, being an amount that must reflect all applicable margin thresholds, minimum transfer amounts, independent amounts and initial margins under the margin agreement.

(2) An authorized institution must use Formula 23D to calculate the add-on mentioned in subsection (1)(b).

Formula 23D

Calculation of Add-on

$$E\left[\max\left(\Delta MtM, 0\right)\right]$$

where—

(a) E[..] is the expectation (being the average over scenarios); and

(b) ΔMtM is the possible change of the mark-to-market value of the transactions in the netting set during the margin period of risk but—

(i) changes in the value of collateral need to be reflected using the applicable standard supervisory haircuts (within the meaning of section 51(1)) with no collateral payments assumed during the margin period of risk; and

(ii) the margin period of risk must be subject to adjustment as set out in section 226M.

226M. Margin period of risk

(1) Subject to subsections (2), (3) and (5), if the transactions in a netting set are subject to daily remargining and daily mark-to-market, an authorized institution must subject the margin period of risk of the netting set used for calculating default risk exposure in respect of netting sets subject to margin agreements to the following supervisory floors—

(a) 5 business days if the netting set consists of repo-style transactions only; and

(b) 10 business days in any other case.

(2) An authorized institution must, if a netting set contains more than 5,000 transactions at any point in time during a quarter, impose a supervisory floor of 20 business days on the margin period of risk for that netting set for the following quarter.

(3) An authorized institution must, if a netting set contains at least one transaction—

(a) that involves illiquid collateral; or

(b) that is an OTC derivative transaction or a credit derivative contract that cannot be easily replaced,

impose a supervisory floor of 20 business days on the margin period of risk for that netting set.

(4) For the purposes of subsection (3)—

(a) an authorized institution must determine whether or not collateral is illiquid collateral and whether or not an OTC derivative transaction or a credit derivative contract is one that cannot be easily replaced—

(i) on the assumption of stressed market conditions; and

(ii) taking into consideration whether, for the collateral, transaction or contract concerned, there are continuously active markets where a counterparty would, within 2 or fewer business days, obtain multiple price quotations that would not move the market or represent a price reflecting a market discount (in the case of collateral) or premium (in the case of an OTC derivative transaction or credit derivative contract);

(b) a transaction is cannot be easily replaced if—

(i) the transaction is not marked-to-market daily; or

(ii) the fair value of the transaction, or the fair value of the asset underlying the transaction, is determined by models using inputs that are not observable in the market; and

(c) an authorized institution must consider whether the transactions undertaken by it or the assets it holds as collateral are concentrated in a particular counterparty, and if that counterparty exited the market precipitously, whether the institution would be able to replace those transactions or assets, as the case may be.

(5) An authorized institution must, if it has experienced more than 2 margin call disputes over a particular netting set during the previous 2 quarters and the disputes have lasted longer than the margin period of risk applicable to that netting set under subsection (1), (2) or (3), as the case requires, use a margin period of risk that is at least double the supervisory floor

applicable to that netting set under that subsection for the subsequent 2 quarters.

(6) An authorized institution must, for a netting set that is not subject to daily remargining, set the margin period of risk at not less than the margin period of risk calculated by using Formula 23E.

Formula 23E

Calculation of Margin Period of Risk for Netting Set Not Subject to Daily Remargining

$$\text{Margin period of risk} = F+N-1$$

where—

F = the supervisory floor specified in subsection (1), (2) or (3), as the case requires, that is applicable to the netting set; and

N = the actual number of days between each remargining of the netting set.

Division 3—Calculation of CVA Capital Charge

226N. Transactions and contracts to be covered

An authorized institution must calculate a CVA capital charge for all its OTC derivative transactions, credit derivative contracts and (if required by the Monetary Authority under section 10A(6)) SFTs, except the transactions and contracts specified in Schedule 1A.

226O. Application of sections 226P and 226Q

Sections 226P and 226Q apply to an authorized institution that is eligible to use the advanced CVA method to calculate the CVA capital charge.

226P. Advanced CVA method

(1) An authorized institution must calculate its CVA capital charge—

(a) by using the VaR model approved by the Monetary Authority under section 18 for calculating the specific risk for interest rate exposures under the IMM approach; and

(b) in accordance with this section and section 226Q.

(2) An authorized institution must use the VaR model in such a way that—

(a) it models the impact of changes in the credit spreads of counterparties on the CVAs for the counterparties; and

(b) it does not model the sensitivity of the CVAs to changes in other market factors (including the value of the asset, commodity, exchange rate or interest rate to which a derivative contract is referenced).

(3) An authorized institution may reduce its CVA capital charge by taking into account the effect of any eligible CVA hedges.

(4) An authorized institution must, to avoid double counting, ensure that the EEs that are used as inputs in Formula 23F, 23G, 23H or 23I have not been adjusted for any credit risk or CVA risk mitigating effect of any

eligible CVA hedges that the institution intends to use to reduce its CVA capital charge.

(5) If an authorized institution has purchased credit protection in the form of a recognized credit derivative contract from a protection seller for a default risk exposure (***protected exposure***) to a counterparty, the institution must, when using Formula 23F, 23G, 23H or 23I, deduct the credit protection covered portion of the protected exposure from the EE profile of the counterparty and add the credit protection covered portion to the EE profile of the protection seller for all valuation dates (that is t_i) that are not greater than the maturity of the credit protection.

(6) Subject to subsection (4), an authorized institution must generate all the inputs used in its approved VaR model mentioned in subsection (1)(a) based on Formula 23F.

Formula 23F

Inputs to be Used in Approved VaR Model Mentioned in Section 226P(1)

$$\text{CVA} = \left(LGD_{MKT}\right) \cdot \sum_{i=1}^{T} Max\left(0; \exp\left(-\frac{s_{i-1} \cdot t_{i-1}}{LGD_{MKT}}\right) - \exp\left(-\frac{s_i \cdot t_i}{LGD_{MKT}}\right)\right) \cdot \left(\frac{EE_{i-1} \cdot D_{i-1} + EE_i \cdot D_i}{2}\right)$$

where—

(a) CVA is the CVA for a particular counterparty;

(b) t_i is the time of the i-th revaluation, starting from $t_0 = 0$;

(c) t_T is the longest contractual residual maturity across the netting sets with the counterparty;

(d) s_i is the credit spread of the counterparty at time t_i but—

(i) the credit default swap (CDS) spread of the counterparty must be used whenever such a spread is available; and

(ii) if the CDS spread is not available, a proxy spread must be used that is appropriate to the counterparty having regard to the credit rating, industry and geographical location of the counterparty;

(e) LGD_{MKT} is the loss given default of the counterparty determined based on the spread of a market instrument of the counterparty but, if a market instrument of the counterparty is not available, a proxy spread must be used that is appropriate to the counterparty having regard to the credit rating, industry and geographical location of the counterparty;

(f) EE_i is the EE to the counterparty at time t_i, that is the sum of the individual EEs of all the netting sets with the counterparty; and

(g) D_i is the default risk-free discount factor at time t_i, where $D_0 = 1$.

(7) An authorized institution using the IRB approach must not use the LGD estimated for a counterparty under the IRB approach as the LGD_{MKT} for that counterparty.

(8) Where an authorized institution's approved VaR model mentioned in subsection (1)(a) is based on full re-

pricing, the institution must use Formula 23F to calculate the CVA.

(9) Subject to subsection (4), where an authorized institution's approved VaR model mentioned in subsection (1)(a) is based on credit spread sensitivities for specific tenors, the institution must generate each credit spread sensitivity based on Formula 23G for i < T and on Formula 23H for i = T.

Formula 23G

Calculation of Credit Spread Sensitivity for Specific Tenors for: i < T

$$\text{Regulatory CS01}_i = 0.0001 \cdot t_i \cdot \exp\left(-\frac{s_i \cdot t_i}{LGD_{MKT}}\right) \cdot \left(\frac{EE_{i-1} \cdot D_{i-1} - EE_{i+1} \cdot D_{i+1}}{2}\right)$$

where—

(a) Regulatory $CS01_i$ = regulatory sensitivity of CVA to 1 basis point change in credit spread at time t_i; and

(b) other components have the same meaning as in Formula 23F.

Formula 23H

Calculation of Credit Spread Sensitivity for Specific Tenors for: i = T

Regulatory $CS01_T$ = $0.0001 \cdot t_T \cdot \exp\left(-\frac{s_T \cdot t_T}{LGD_{MKT}}\right) \cdot \left(\frac{EE_{T-1} \cdot D_{T-1} + EE_T \cdot D_T}{2}\right)$

where—

Regulatory $CS01_T$ = regulatory sensitivity of CVA to 1 basis point change in credit spread at time t_T.

(10) Subject to subsection (4), where an authorized institution's approved VaR model mentioned in subsection (1)(a) is based on credit spread sensitivities to parallel shifts in credit spreads, the institution must generate the credit spread sensitivity based on Formula 23I.

Formula 23I

Calculation of Credit Spread Sensitivity to Parallel Shifts

Regulatory CS01 = $0.0001 \cdot \sum_{i=1}^{T}\left(t_i \cdot \exp\left(-\frac{s_i \cdot t_i}{LGD_{MKT}}\right) - t_{i-1} \cdot \exp\left(-\frac{s_{i-1} \cdot t_{i-1}}{LGD_{MKT}}\right)\right) \cdot \left(\frac{EE_{i-1} \cdot D_{i-1} + EE_i \cdot D_i}{2}\right)$

where—

Regulatory CS01 = regulatory sensitivity of

CVA to 1 basis point parallel shift in credit spreads.

(11) Where an authorized institution's approved VaR model mentioned in subsection (1)(a) is based on second-order sensitivities to shifts in credit spreads (spread gammas), the institution must calculate the spread gammas based on Formula 23F.

(12) An authorized institution using the shortcut method set out in section 226L must calculate the CVA capital charge for a counterparty by—

(a) using Formula 23F; and

(b) applying to Formula 23F a constant EE profile with EE set equal to the effective EPE determined under the shortcut method for a maturity equal to the greater of—

(i) half of the longest residual maturity occurring in the netting set concerned; or

(ii) the weighted average residual maturity of all transactions in the netting set (using the notional amount of each transaction for weighting the maturity).

(13) An authorized institution must include transactions which are not covered by its IMM(CCR) approval or for which the institution is permitted under section 10B(5), or has chosen under section 10B(7),to use the current exposure method or the methods mentioned in section 10A(1)(b) in its CVA capital charge calculation under the advanced CVA method by assuming a constant EE profile for such transactions for the purposes of Formula 23F, 23G, 23H or 23I, as the case requires, with EE set equal to the default risk exposure as calculated under the

current exposure method or any of the methods mentioned in section 10A(1)(b) for a residual maturity equal to the greater of—

(a) half of the longest residual maturity occurring in the netting set concerned; or

(b) the weighted average residual maturity of all transactions in the netting set (using the notional amount of each transaction for weighting the maturity).

(14) An authorized institution must include transactions for which the internal model used by it does not produce an EE profile in its CVA capital charge calculation under the advanced CVA method in accordance with the method set out in subsection (13).

226Q. Specific requirements relating to VaR under advanced CVA method

(1) An authorized institution using the advanced CVA method to calculate the CVA capital charge must—

(a) ensure that the CVA capital charge covers general and specific credit spread risks and, if the institution has the Monetary Authority's approval to calculate incremental risk charge for transactions that are subject to the CVA capital charge, excludes the incremental risk charge;

(b) determine the CVA capital charge as the sum of a VaR and a stressed VaR generated by the model mentioned in section 226P(1)(a) used by the institution; and

(c) determine the VaR and the stressed VaR mentioned in paragraph (b) in accordance with the quantitative

standards set out in subsections (2) and (3) and section 1(n) of Schedule 3.

(2) An authorized institution must—

(a) calculate the VaR based on EEs that are estimated using parameters calibrated to current market data; and

(b) determine the VaR as the higher of—

(i) the institution's VaR as at the last trading day; or

(ii) the average VaR for the last 60 trading days multiplied by a multiplication factor determined in the manner set out in section 319(1).

(3) An authorized institution must—

(a) calculate the stressed VaR based on EEs that are estimated using a stress calibration as set out in section 3(f)(i) of Schedule 2A; and

(b) determine the stressed VaR as the higher of—

(i) the institution's latest available stressed VaR; or

(ii) the average stressed VaR for the last 60 trading days multiplied by a multiplication factor determined in the manner set out in section 319(4).

(4) For the purposes of subsection (3), the period of stress must be the most severe one-year stress period within the 3-year period used for the stress calibration.

226R. Application of section 226S

Section 226S applies to an authorized institution that is required to use the standardized CVA method to calculate the CVA capital charge.

226S. Standardized CVA method

(1) An authorized institution must use Formula 23J to calculate the CVA capital charge for a portfolio of counterparties.

Formula 23J

Calculation of CVA Capital Charge under Standardized CVA Method

$$K = 2.33 \cdot \sqrt{h} \cdot \sqrt{\left(\sum_i 0.5 \cdot w_i \cdot \left(M_i \cdot EAD_i^{total} - M_i^{hedge} B_i \right) - \sum_{ind} w_{ind} \cdot M_{ind} \cdot B_{ind} \right)^2 + A}$$

$$A = \sum_i 0.75 \cdot w_i^2 \cdot \left(M_i \cdot EAD_i^{total} - M_i^{hedge} \cdot B_i \right)^2$$

where—

(a) h is the one-year risk horizon (in units of a year) and h = 1;

(b) w_i is the weight applicable to counterparty "i", which is determined by mapping the ECAI issuer rating of the counterparty to one of the 7 weights in Table 23A or Table 23B, whichever is applicable, but, where a counterparty does not have an ECAI issuer rating—

(i) an authorized institution that uses the IRB approach to calculate its credit risk for non-securitization exposures to the counterparty must, subject to the prior consent of the Monetary Authority, map the internal rating

of the counterparty to one of the ECAI issuer ratings in Table 23A in order to determine the weight applicable to the counterparty;

(ii) an authorized institution that uses the BSC or STC approach to calculate its credit risk for non-securitization exposures to the counterparty, or uses the IRB approach to calculate its credit risk for non-securitization exposures to the counterparty but does not have the prior consent mentioned in subparagraph (i), must assign a weight of 1% to the counterparty;

(c) EAD_i^{total} is the default risk exposure (without any adjustment for CVA losses) of a netting set with counterparty "i" with the effect of collateral taken into account in such a manner as permitted under the IMM(CCR) approach, the current exposure method or the methods mentioned in section 10A(1)(b), as the case may be, but, for the purposes of calculating EAD_i^{total} —

(i) subject to subparagraph (ii), if an authorized institution does not have an IMM(CCR) approval for using the IMM(CCR) approach to calculate the default risk exposure of the netting set, the institution must discount the default risk exposure of that netting set by a factor that is equal to $(1-\exp(-0.05M_i))/(0.05M_i)$;

(ii) if the default risk exposure of the netting set is calculated by using the IMM(CCR) approach, the discount referred to in subparagraph (i) is not required;

(d) B_i is the notional amount of a single-name credit default swap, with counterparty "i" as the reference entity, purchased for hedging CVA risk but this notional amount must be discounted by a factor that is equal to $\left(1-\exp\left(-0.05M_i^{hedge}\right)\right)/\left(0.05M_i^{hedge}\right)$;

(e) B_{ind} is the notional amount of an index credit default swap on index "ind" purchased for hedging CVA risk but—

(i) the authorized institution must discount the notional amount by a factor that is equal to $(1-\exp(-0.05M_{ind}))/(0.05M_{ind})$;

(ii) if counterparty "i" is a constituent of index "ind", the notional amount attributable to that counterparty (based on its weight in the index credit default swap concerned) may, with the prior consent of the Monetary Authority, be subtracted by the authorized institution from the notional amount of the swap and be treated by the institution as a single-name credit default swap on that counterparty (that is, may be included in the calculation of B_i) with maturity based on the maturity of index "ind";

(f) w_{ind} is the weight applicable to the index credit default swap mentioned in paragraph (e), which is determined by mapping index "ind" to one of the 7 weights in Table 23A based on the average spread of index "ind";

(g) M_i is the effective maturity of a netting set with counterparty "i" but—

(i) if the institution has an IMM(CCR) approval for using the IMM(CCR) approach to calculate the default risk exposure of the netting set, it must calculate M_i as the greater of one year or the M calculated in accordance with section 168(1)(ba);

(ii) if the institution does not have an IMM(CCR) approval for using the IMM(CCR) approach to calculate the default risk exposure of the netting set, it must calculate M_i as the greater of one year or the M calculated in accordance with section 168(1)(b) or (d), as the case requires; and

(iii) the institution must not cap M_i at 5 years for the purposes of calculating the CVA capital charge;

(h) M_i^{hedge} is the maturity of the credit default swap mentioned in paragraph (d); and

(i) M_{ind} is the maturity of the credit default swap mentioned in paragraph (e).

Table 23A

Ratings Applicable to All Counterparties

Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.	Weight
AAA	Aaa	AAA	AAA	AAA	0.7%
AA+	Aa1	AA+	AA+	AA+	0.7%

Standard & Poor's Ratings Services	Moody's Investors Service	Fitch Ratings	Rating and Investment Information, Inc.	Japan Credit Rating Agency, Ltd.	Weight
AA AA-	Aa2 Aa3	AA AA-	AA AA-	AA AA-	
A+ A A-	A1 A2 A3	A+ A A-	A+ A A-	A+ A A-	0.8%
BBB+ BBB BBB-	Baa1 Baa2 Baa3	BBB+ BBB BBB-	BBB+ BBB BBB-	BBB+ BBB BBB-	1.0%
BB+ BB BB-	Ba1 Ba2 Ba3	BB+ BB BB-	BB+ BB BB-	BB+ BB BB-	2.0%
B+ B B-	B1 B2 B3	B+ B B-	B+ B B-	B+ B B-	3.0%
CCC+ CCC CCC-	Caa1 Caa2 Caa3	CCC	CCC+ CCC CCC-	CCC	10.0%

Table 23B

Ratings Applicable to Counterparties that are Corporates Incorporated in India

Credit Analysis and Research Limited	CRISIL Limited	ICRA Limited	Weight
CARE AAA (Is)	CRISIL AAA	IrAAA	0.7%
CARE AA+ (Is)	CRISIL AA+	IrAA+	0.8%
CARE AA (Is)	CRISIL AA	IrAA	
CARE AA- (Is)	CRISIL AA-	IrAA-	
CARE A+ (Is)	CRISIL A+	IrA+	0.8%
CARE A (Is)	CRISIL A	IrA	
CARE A- (Is)	CRISIL A-	IrA-	
CARE BBB+ (Is)	CRISIL BBB+	IrBBB+	1.0%
CARE BBB (Is)	CRISIL BBB	IrBBB	
CARE BBB- (Is)	CRISIL BBB-	IrBBB-	
CARE BB+ (Is)	CRISIL BB+	IrBB+	2.0%
CARE BB (Is)	CRISIL BB	IrBB	
CARE BB- (Is)	CRISIL BB-	IrBB-	
CARE B+ (Is)	CRISIL B+	IrB+	3.0%
CARE B (Is)	CRISIL B	IrB	
CARE B- (Is)	CRISIL B-	IrB-	
CARE C+ (Is)	CRISIL C+	IrC+	10.0%
CARE C (Is)	CRISIL C	IrC	
CARE C- (Is)	CRISIL C-	IrC-	

(2) In complying with subsection (1)(b), if counterparty "i" has more than one ECAI issuer rating the use of which would result in the allocation of different weights to counterparty "i" under Table 23A or 23B, an authorized institution must use any one of those ratings except the

one or more of those ratings that would result in the allocation by the institution of the lowest of those different weights.

(3) An authorized institution must, if there is more than one netting set with counterparty "i", construe the expression $M_i \cdot EAD_i^{total}$ in Formula 23J as the sum of the quantities $M_i \cdot EAD_i^{total}$ calculated for the netting sets.

(4) An authorized institution must, if there is more than one single-name credit default swap purchased for hedging the CVA risk in respect of counterparty "i", construe the expression $M_i^{hedge} \cdot B_i$ in Formula 23J as the sum of the quantities $M_i^{hedge} \cdot B_i$ calculated for the swaps.

(5) An authorized institution must, if there is more than one index credit default swap purchased for hedging CVA risk, construe the expression $M_{ind} \cdot B_{ind}$ in Formula 23J as the sum of the quantities $M_{ind} \cdot B_{ind}$ calculated for the swaps.

(6) An authorized institution—

(a) subject to paragraph (b), must not include a CVA hedge in its use of Formula 23J unless it is an eligible CVA hedge;

(b) must, to avoid double counting in EAD_i^{total} in that formula, ensure that EAD_i^{total} has not been adjusted for any credit risk or CVA risk mitigating effect of any eligible CVA hedges that the institution intends to use to reduce its CVA capital charge;

(7) If an authorized institution has purchased credit protection in the form of a recognized credit derivative contract from a protection seller for a default risk exposure (***protected exposure***) to a counterparty, the institution must deduct the product of the credit protection covered portion of the protected exposure and

the residual maturity of the credit protection from the $M \cdot EAD^{total}$ of the counterparty and add the product to the $M \cdot EAD^{total}$ of the protection seller.

226T. Eligible CVA hedges

(1) An authorized institution, when calculating a CVA capital charge, may take hedges into account only if—

(a) the hedges are used and managed for the purpose of mitigating CVA risk;

(b) the hedges are entered into with external counterparties so that the CVA risk is transferred outside the institution and, if the institution is part of a group, outside the group;

(c) subject to paragraph (d), the hedging instruments used in the hedges are—

(i) single-name credit default swaps;

(ii) single-name contingent credit default swaps;

(iii) hedging instruments equivalent to the hedging instruments mentioned in subparagraph (i) or (ii) and referencing the counterparty concerned directly; or

(iv) subject to subsection (2), index credit default swaps;

(d) the hedges are not—

(i) tranched or nth-to-default credit default swaps;

(ii) credit-linked notes; or

(iii) first loss protection; and

(e) the payment under the hedging instruments used in the hedges does not depend on cross-default.

(2) Where an authorized institution uses the advanced CVA method to calculate the CVA capital charge, the institution may, subject to subsection (3), include index credit default swaps as eligible CVA hedges in the calculation only if—

(a) the basis (being the difference between the spread of any individual counterparty (or, subject to paragraph (b), the proxy spread when the spread is not available) and the spreads of the index credit default swaps) is reflected in the VaR generated by the VaR model concerned;

(b) in any case where the counterparty has no available spread, the institution uses a reasonable basis time series out of a representative group of similar names for which a spread is available to determine a proxy spread.

(3) Where the Monetary Authority is not satisfied that the basis referred to in subsection (2) is sufficiently reflected in an authorized institution's VaR, the Monetary Authority may give the institution a notice in writing requiring the institution to reflect, in its VaR, 50% of the notional amount of the index credit default swap hedge concerned.

(4) An authorized institution must comply with the requirements of a notice given to it under subsection (3).

(5) An authorized institution must, if the hedging instrument in an eligible CVA hedge is a credit default swap and restructuring is not one of the credit events specified in the swap, take into account the CVA risk mitigating effect of the swap in its CVA capital charge calculation—

(a) if the institution calculates CVA capital charge using the advanced CVA method, in the same manner as that under the IMM approach in respect of the use of credit default swaps to offset the market risk capital charge for specific risk;

(b) if the institution calculates CVA capital charge using the standardized CVA method, in accordance with sections 308, 309, 310 and 311, insofar as they relate to credit default swaps and with all necessary modifications.

(6) Where an authorized institution has included eligible CVA hedges in a CVA capital charge calculation, the institution—

(a) must exclude the hedges from its market risk capital charge calculation;

(b) must not treat the hedges as recognized credit derivative contracts other than for CVA risk; and

(c) must, if its default risk exposure to the protection sellers of the eligible CVA hedges calculated by the IMM(CCR) approach or the current exposure method is larger than zero, include the default risk exposure in its CVA capital charge calculation and must not set the default risk exposure to zero.

Division 4—Exposures to CCPs

226U. Application of Division 4

(1) This Division applies to any authorized institution, regardless of the approach adopted by the institution for calculating its credit risk for non-securitization exposures.

(2) Unless otherwise specified in this Division, CCPs are treated as securities firms for the purposes of Parts 4, 5 and 6.

(3) To avoid doubt, exposures to CCPs, clearing members or clients arising from delayed or failed settlement of—

(a) cash transactions in securities (other than repo-style transactions), foreign exchange or commodities; and

(b) cash-settled derivative contracts,

are not subject to the requirements of this Division but are subject to the capital treatments set out in Part 4, 5 or 6, as the case requires, for transactions settled on a delivery-versus-payment basis or a basis other than the delivery-versus-payment basis.

226V. Interpretation of Division 4

(1) In this Division—

Committee on Payment and Settlement Systems ( ) means the committee, whose secretariat is hosted by the Bank for International Settlements in Basel, Switzerland, that serves as a forum for central banks to monitor and analyze developments in domestic payment, clearing and settlement systems as well as in cross-border and multicurrency settlement schemes;

initial margin ( ), in relation to the calculation of regulatory capital for exposures to CCPs and clearing members—

(a) subject to paragraph (b), means a clearing member's or a client's collateral posted to a CCP to mitigate the potential future exposure of the CCP to the clearing member arising from the possible future change in the value of the clearing member's

transactions or the client's transactions, as the case may be;

(b) does not include—

(i) any default fund contributions made by the clearing member; and

(ii) any collateral posted by the clearing member or client that can be used by the CCP to mutualize losses among clearing members;

International Organization of Securities Commissions ( ) means the international association of securities regulators, whose general secretariat is based in Madrid, Spain, that sets international standards for securities markets and promotes information exchange and co-operation among its members;

non-qualifying CCP ( ) means a CCP that is not a qualifying CCP;

offsetting transaction ( ), in relation to a clearing member of a CCP and a client of the clearing member, means a transaction between the clearing member and the CCP that is for the purpose of offsetting a transaction between the clearing member and the client when the clearing member acts on behalf of the client as an intermediary between the client and the CCP;

qualifying CCP ( ) means a CCP—

(a) that has been granted a licence by a regulator or overseer to operate as a CCP (including a licence granted by way of confirming an exemption) and is permitted by the regulator or overseer to operate as such with respect to products offered by the CCP;

(b) that is based and prudentially supervised in a jurisdiction where the regulator or overseer has

established, and publicly indicated that it applies to the CCP on a continuous basis, domestic rules and regulations that are consistent with the principles in the document entitled "Principles for financial market infrastructures" issued by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions, as in force from time to time;

(c) that has made available or calculated the parameters that are necessary for a clearing member to calculate the regulatory capital for its default fund contribution to the CCP in accordance with the methodology and requirements set out in paragraph 123 of Annex 4 (as amended by the document entitled "Capital requirements for bank exposures to central counterparties" issued by the Basel Committee in July 2012) to the document entitled "International Convergence of Capital Measurement and Capital Standards: A Revised Framework—Comprehensive Version" published by the Basel Committee in June 2006 and for the relevant banking supervisory authority of the clearing member to review the capital charge calculations performed by the clearing member; and;

(d) that provides to its clearing members and their relevant banking supervisory authorities, and updates, the parameters mentioned in paragraph (c) at least on a quarterly basis and whenever there are material changes to the number or exposure of cleared transactions or material changes to the financial resources of the CCP;

variation margin ( ), in relation to the calculation of regulatory capital for exposures to CCPs and clearing members, means a clearing member's or client's collateral posted on a daily or intraday basis to a CCP based on price movements of the clearing member's transactions or client's transactions, as the case may be.

(2) For the purposes of this Division—

(a) an authorized institution's default risk exposure to a CCP includes any initial margin posted by the institution and any variation margin that is payable by the CCP to the institution; and

(b) in determining whether any netting done pursuant to a netting agreement with a CCP is recognized netting—

(i) any reference to agreement in the definition of ***valid bilateral netting agreement*** in section 2(1); or

(ii) any reference to bilateral master agreement in section 226B(2),

is to be construed as a netting agreement employed by a CCP that provides legally enforceable rights of set-off.

226W. Calculation of credit risk exposures

(1) An authorized institution must calculate its default risk exposure to a CCP, a clearing member or a client in respect of OTC derivative transactions, credit derivative contracts and SFTs using the same methodology as it would be required to use if the transactions or contracts—

(a) were not cleared by CCPs; or

(b) were not CCP-related transactions or offsetting transactions.

(2) Where an authorized institution's transaction with a CCP is a derivative contract traded on an exchange, the institution must calculate its default risk exposure in respect of the contract using the same methodology as it would be required to use if the contract were an OTC derivative transaction or a credit derivative contract, as the case requires.

(3) An authorized institution may treat the default risk exposure to a CCP, in respect of payment transactions or spot transactions, as zero if the CCP's default risk exposures to all clearing members are fully collateralized on a daily basis.

(4) If a credit exposure to a CCP arises from the holding by the CCP of collateral posted by an authorized institution, and the collateral is not held on a bankruptcy basis, the credit exposure is taken to be equal to the fair value of the collateral.

(5) For the purposes of subsections (1) and (2), if a netting set with a CCP falls within the description in section 226M(2) and an authorized institution uses the IMM(CCR) approach or any of the methods under sections 76A(4) to (7), 96, 97, 123A(4) to (7), 202(1) and (3) and 209(3) to calculate the default risk exposure in respect of the netting set, the higher supervisory floor of 20 business days required under section 226M(2) does not apply to the calculation of the default risk exposure only if the netting set—

(a) does not contain illiquid collateral or transactions that cannot be easily replaced; and

(b) does not contain any disputed transactions.

226X. Exposures of clearing members to qualifying CCPs

(1) An authorized institution that is a clearing member of a qualifying CCP must calculate the risk-weighted amount of its—

(a) default risk exposure to the CCP in respect of derivative contracts or SFTs entered into with the CCP for the institution's own purposes; and

(b) default risk exposure to the CCP that arises when the institution provides clearing services to its clients and is obliged to reimburse the clients for any loss suffered by them due to changes in the value of their transactions in the event that the CCP defaults,

by allocating a risk-weight of 2% to the exposures.

(2) For the purposes of subsection (1), an authorized institution may calculate the risk-weighted amount taking into account any credit risk mitigation techniques (including recognized netting and margining) that are recognized under these Rules in the same manner as permitted for the calculation of the risk-weighted amount of its default risk exposures in respect of bilateral transactions.

(3) An authorized institution must not under subsection (2) take into account the effect of any credit risk mitigation techniques applicable to an exposure of the institution if that effect has already been taken into account in the calculation of its default risk exposures in respect of the transactions or contracts concerned.

(4) An authorized institution that is a clearing member of a qualifying CCP must apply a risk-weight of 1250% to its funded default fund contribution to the CCP, or, subject to section 226Y(4), use Formula 23K to calculate the

regulatory capital for its default fund contribution (K_{AI}) to the CCP.

Formula 23K

Calculation of Regulatory Capital for Default Fund Contribution by Authorized Institution that is Clearing Member of Qualifying CCP

$$K_{AI} = \left(1 + \beta \cdot \frac{N}{N-2}\right) \cdot \frac{DF_{AI}}{DF_{CM}} \cdot K_{CM}^{*}$$

where—

(a) $\beta = \frac{A_{Net,1} + A_{Net,2}}{\sum_i A_{Net,i}}$ where subscripts 1 and 2 denote the clearing members with the 2 largest A_{Net} values and subscript i denotes clearing member "i" but—

(i) for derivative contracts, A_{Net} is an amount calculated as $0.15*A_{Gross} + 0.85*NGR*A_{Gross}$ where A_{Gross} and NGR have the same meaning as in section 95;

(ii) for SFTs, A_{Net} is an amount calculated as $E \cdot H_e + C \cdot \left(H_c + H_{fx}\right)$ where—

(A) E is the amount of the CCP's exposure to the SFTs;

(B) C is the current market value of the collateral, which would fall within the definition of ***recognized collateral*** in section 51(1) if the CCP were an authorized institution, received by the CCP; and

(C) H_e, H_c and H_{fx} are haircuts that would have the meaning given by Formula 2 in section 87 and subject to section 90 if the CCP were an authorized institution;

(b) N = number of clearing members;

(c) DF_{AI} = funded default fund contribution from the authorized institution;

(d) DF_{CM} = total of funded default fund contributions from all clearing members; and

(e) K^*_{CM} = aggregate capital requirement on default fund contributions from all clearing members before adjustments for granularity and concentration calculated in accordance with the methodology set out in paragraph 123 of Annex 4 (as amended by the document entitled "Capital requirements for bank exposures to central counterparties" issued by the Basel Committee in July 2012) to the document entitled "International Convergence of Capital Measurement and Capital Standards: A Revised Framework—Comprehensive Version" published by the Basel Committee in June 2006.

(5) An authorized institution that intends to apply a risk-weight of 1250% to its funded default fund contribution to a CCP under subsection (4) may disregard paragraphs (c) and (d) of the definition of ***qualifying CCP*** in section 226V(1) when determining whether the CCP is a qualifying CCP.

(6) If an authorized institution has chosen to apply a risk-weight of 1250% to its funded default fund contribution

to a qualifying CCP under subsection (4), the total risk-weighted amount of the institution's default risk exposures and default fund contribution to the CCP ($RWA_{(TE+DF)}$) is to be calculated as follows:

$$RWA_{(TE+DF)} = Min\{(2\%*TE_i + 1250\%*DF_{AI}); 20\%*TE_i\}$$

where—

TE_i = the total of the default risk exposures of the authorized institution mentioned in section 226X(1) to the CCP.

226Y. Provisions supplementary to section 226X(4)

(1) An authorized institution must, if Formula 23K cannot work because the CCP does not have any funded default fund contributions, calculate K_{AI} by allocating K_{CM}^{*} based on $\frac{UDF_{AI}}{UDF_{CM}}$ instead of based on $\frac{DF_{AI}}{DF_{CM}}$, where—

(a) UDF_{AI} = the institution's unfunded default fund commitment; and

(b) UDF_{CM} = the total of all clearing members' unfunded default fund commitment.

(2) An authorized institution must, if the authorized institution's share of K_{CM}^{*} based on its proportionate unfunded default fund commitment is not determinable, allocate K_{CM}^{*} based on $\frac{IM_{AI}}{IM_{CM}}$ instead of based on $\frac{DF_{AI}}{DF_{CM}}$, where—

(a) IM_{AI} = the initial margin posted by the institution to the CCP; and

(b) IM_{CM} = the total of initial margin posted by all clearing members to the CCP.

(3) An authorized institution must recalculate K_{AI}—

(a) at least on a quarterly basis; and

(b) whenever there are material changes to—

(i) the number of cleared transactions of the institution or CCP;

(ii) the exposure of the institution or CCP in respect of cleared transactions; or

(iii) the financial resources of the CCP.

(4) The Monetary Authority may, if a CCP's mutualized loss sharing arrangements would not allocate losses to its clearing members proportionate to their funded default fund contributions, and after consultation with the authorized institution concerned, by notice in writing given to the institution require it to make adjustments specified in the notice to the allocation methodology used in Formula 23K or set out in subsection (1) or (2), as the case may be, in order to reflect the loss allocation basis under the mutualized loss sharing arrangements of that CCP.

(5) An authorized institution must comply with the requirements of a notice given to it under subsection (4).

(6) An authorized institution must calculate the risk-weighted amount of its exposure to the CCP in respect of its default fund contribution as the product of K_{AI} and 12.5.

226Z. Exposures of clearing members to clients

(1) An authorized institution that is a clearing member of a CCP must calculate—

(a) the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of its clients arising from CCP-related transactions; and

(b) the risk-weighted amount of its default risk exposures and CVA risk-weighted amount arising from guarantees of clients' performance,

in accordance with Part 4, 5 or 6, as the case requires, and Division 3 of Part 6A.

(2) Where an authorized institution—

(a) is a clearing member of CCP; and

(b) has entered into a transaction, being the CCP-related transaction for a derivative contract traded on an exchange, with its client under a bilateral agreement between the institution and its client,

the institution must calculate the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of the client arising from the derivative contract as if the derivative contract were an OTC derivative transaction.

(3) In calculating the default risk exposure that enters into the risk-weighted amount calculation mentioned in subsections (1) and (2)—

(a) an authorized institution that uses the IMM(CCR) approach may, despite section 226M(1), apply a margin period of risk of at least 5 business days to a netting set that would otherwise subject to a

margin period of risk of 10 business days under section 226M(1); and

(b) an authorized institution that calculates the default risk exposure using methods other than the IMM(CCR) approach may multiply the default risk exposure so calculated by a scaling factor in accordance with subsection (4).

(4) The scaling factor mentioned in subsection (3)(b) is to be determined by mapping the margin period of risk of the transaction concerned to the applicable scaling factor in accordance with Table 23C.

Table 23C

Scaling Factors Applicable to Margin Periods of Risk

Margin period of risk	Scaling factor
5 business days	0.71
6 business days	0.77
7 business days	0.84
8 business days	0.89
9 business days	0.95
10 business days or more	1

226ZA. Exposures of clients to clearing members

(1) Where an authorized institution—

(a) is a client of a clearing member of a CCP; and

(b) enters into a CCP-related transaction (***relevant transaction***) with the clearing member that acts as a financial intermediary between the institution and the CCP,

the institution must, subject to subsections (3), (4) and (5), calculate the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of the clearing member arising from the relevant transaction in accordance with Part 4, 5 or 6, as the case requires, and Division 3 of Part 6A.

(2) Where an authorized institution—

(a) is a client of a clearing member of a CCP; and

(b) has entered into a transaction, being the CCP-related transaction for a derivative contract traded on an exchange, with the clearing member under a bilateral agreement between the institution and the clearing member,

the institution must calculate the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of the clearing member arising from the derivative contract as if the derivative contract were an OTC derivative transaction.

(3) An authorized institution may, if the CCP is a qualifying CCP and all the conditions set out in subsection (5) are met, calculate the risk-weighted amount of its exposure to the clearing member arising from the relevant transaction in accordance with section 226X(1) to (3) as if its exposure were to the CCP.

(4) An authorized institution may, if the CCP is a qualifying CCP and all the conditions set out in subsection (6) (excluding the condition set out in subsection (6)(a)(iii)) are met, calculate the risk-weighted amount of its exposure to the clearing member arising from the relevant transaction in accordance with section 226X(1) to (3) as if its exposure were to the CCP except that the applicable risk-weight must be 4% instead of 2%.

(5) An authorized institution may, if the CCP is a non-qualifying CCP and all the conditions set out in subsection (6) (excluding the condition set out in subsection (6)(a)(iii)) are met, calculate the risk-weighted amount of its exposure to the clearing member arising from the relevant transaction in accordance with section 226ZD(1) as if its exposure were to the CCP.

(6) The conditions that must be met for the relevant transaction of an authorized institution to receive the treatment mentioned in subsection (3) are—

(a) the offsetting transaction for the relevant transaction is identified by the CCP as a client transaction and the collateral for supporting the offsetting transaction is held by the CCP or the clearing member, or both, as applicable, under arrangements that prevent any losses to the institution due to—

(i) the default or insolvency of the clearing member;

(ii) the default or insolvency of the clearing member's other clients; and

(iii) the joint default or joint insolvency of the clearing member and any of its other clients;

(b) the institution has obtained independent, written and reasoned legal advice that concludes that, in the event of a legal challenge in a court of law or before an administrative authority, the relevant court or administrative authority would find that the institution would bear no losses on account of the insolvency of the clearing member or of any other clients of the clearing member under—

(i) the law of the jurisdictions in which the institution, the clearing member and the CCP are incorporated or the equivalent locations in the case of non-corporate entities, and if a branch of the institution, the clearing member or the CCP is involved, then also under the law of the jurisdiction in which the branch is located;

(ii) the law that governs the individual transactions and collateral; and

(iii) the law that governs any contract or agreement necessary to meet the condition set out in paragraph (a); and

(c) relevant laws, regulations, rules, contractual or administrative arrangements provide that offsetting transactions with a clearing member are highly likely to continue to be indirectly transacted through the CCP, or by the CCP, if the clearing member defaults or becomes insolvent, and in such circumstances, the institution's positions and collateral with the CCP will be transferred at market value unless the institution requests to close out the positions at market value.

226ZB. Exposures of clients to CCPs

(1) Subject to subsections (2), (3) and (4), where an authorized institution is a client of a clearing member of a CCP, if the institution enters into a transaction with the CCP and has its performance under the transaction guaranteed by the clearing member, the institution must calculate the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of the clearing member arising from the transaction in

accordance with Part 4, 5 or 6, as the case requires, and Division 3 of Part 6A.

(2) The authorized institution may calculate the risk-weighted amount of its exposure to a qualifying CCP arising from the transaction in accordance with section 226X(1) to (3) if all the conditions set out in section 226ZA(6) are met.

(3) The authorized institution may, if the CCP is a qualifying CCP and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met, calculate the risk-weighted amount of its exposure to the CCP arising from the transaction in accordance with section 226X(1) to (3) except that the applicable risk-weight must be 4% instead of 2%.

(4) The authorized institution may, if the CCP is a non-qualifying CCP and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met, calculate the risk-weighted amount of its exposure to the CCP arising from the transaction in accordance with section 226ZD(1).

226ZC. CCP ceases to be qualifying CCP

(1) Where a CCP ceases to be a qualifying CCP—

(a) subject to subsection (2), an authorized institution may, for a period of not more than 3 months commencing on the cessation, continue to calculate its default risk exposure in respect of transactions cleared by the CCP as if the CCP were a qualifying CCP; and

(b) an institution may, at any time before the expiration of the period mentioned in paragraph

(a), and must, on and after the expiration of that period, calculate its default risk exposures in respect of transactions cleared by the CCP on the basis that the CCP is a non-qualifying CCP unless the CCP again becomes a qualifying CCP.

(2) The Monetary Authority may, by notice in writing given to an authorized institution, require the institution to calculate its default risk exposure to a CCP that has ceased to be a qualifying CCP in accordance with the requirements applicable to a non-qualifying CCP, beginning on the date, or the occurrence of the event, specified in the notice.

(3) An authorized institution must comply with the requirements of a notice given to it under subsection (2).

(4) Subsections (1) and (2) apply to the calculation of regulatory capital for default fund contribution to a CCP as they apply to the calculation of default risk exposures in respect of transactions cleared by the CCP.

226ZD. Exposures of clearing members to non-qualifying CCPs

(1) An authorized institution that is a clearing member of a non-qualifying CCP must calculate, in accordance with Part 4, the risk-weighted amount of—

(a) its default risk exposure to the CCP in respect of derivative contracts or SFTs entered into with the CCP; and

(b) its default risk exposure to the CCP arising from guarantees provided by the institution to its clients for any loss due to changes in the value of the clients' transactions in the event that the CCP defaults.

(2) An authorized institution must allocate a risk-weight of 1250% to its default fund contribution to a non-qualifying CCP and, for that purpose, the institution's default fund contribution must include the funded and unfunded contributions that the institution is liable to pay if the non-qualifying CCP requires the institution to do so.

226ZE. Treatment of posted collateral

(1) Subject to subsections (2), (3), (4), (5) and (6), where an authorized institution has posted collateral to a CCP or a clearing member of a CCP and the collateral is not held in a bankruptcy remote manner, the institution must, in respect of the collateral, calculate the risk-weighted amount of its credit exposure to the person holding the collateral by assigning a risk-weight applicable to that person in accordance with Part 4, 5 or 6, as the case requires.

(2) Where the person mentioned in subsection (1) is a CCP, the institution must determine the risk-weight applicable to the CCP in accordance with Part 4, 5 or 6, as the case requires, if the CCP is a qualifying CCP and in accordance with Part 4 if the CCP is a non-qualifying CCP.

(3) Where an authorized institution is a clearing member of a CCP and has posted collateral for transactions with the CCP, the institution is not, in respect of the collateral, required to hold regulatory capital for its credit exposure to the person holding the collateral if—

(a) the collateral is held by a custodian; and

(b) the collateral is bankruptcy remote from the CCP.

(4) Where an authorized institution is a client of a clearing member of a CCP and has posted collateral for transactions with the CCP, the institution is not, in respect of the collateral, required to hold regulatory capital for its credit exposure to the person holding the collateral if—

(a) the collateral is held by a custodian; and

(b) the collateral is bankruptcy remote from the CCP, the clearing member concerned and the other clients of the clearing member.

(5) Subject to subsection (6), where an authorized institution is a client of a clearing member of a CCP and has posted collateral for transactions with the CCP, and the collateral—

(a) is held by the CCP on the institution's behalf; and

(b) is not held on a bankruptcy remote basis,

the institution must calculate the risk-weighted amount of its credit exposure to the clearing member in respect of the collateral by assigning a risk-weight applicable to the clearing member in accordance with Part 4, 5 or 6, as the case requires.

(6) Where an authorized institution is a client of a clearing member of a CCP and has a credit exposure to the CCP in respect of collateral posted by it that falls within subsection (5)(a) and (b)—

(a) a risk-weight of 2% must be allocated to the exposure if the CCP is a qualifying CCP and all the conditions set out in section 226ZA(6) are met;

(b) a risk-weight of 4% must be allocated to the exposure if the CCP is a qualifying CCP and all the conditions set out in section 226ZA(6) (excluding

the condition set out in section 226ZA(6)(a)(iii)) are met; or

(c) a risk-weight determined under Part 4 may be allocated to the exposure if the CCP is a non-qualifying CCP and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met.

(7) To avoid doubt—

(a) if the person mentioned in subsection (1) is a CCP, the collateral mentioned in that subsection does not include any collateral that is regarded as a default risk exposure to the CCP under section 226V(2)(a); and

(b) an authorized institution that has posted an asset as collateral must hold regulatory capital for the credit risk or market risk, whichever is applicable, of the asset itself calculated in accordance with Part 4, 5, 6, 7 or 8, as the case requires, as if it had not been posted as collateral and, if the collateral is held by another person, as if the collateral were held by the institution.

(8) In this section—

custodian ( ) means a trustee, agent, pledgee, secured creditor or any other person that holds property (***property holder***) in a way—

(a) that does not give the property holder a beneficial interest in the property; and

(b) that will not result in the property being subject to legally-enforceable claims by the property holder's creditors, or to a court-ordered stay of the return of

the property, if the property holder become insolvent or bankrupt.".

119. Section 227 amended (interpretation of Part 7)

(1) Section 227(1), definition of ***credit equivalent amount***, paragraph (a)—

Repeal

"has the meaning assigned to it by section 51(1), with all necessary modifications"

Substitute

"means the credit equivalent amount calculated as the product of the principal amount (after deduction of specific provisions) of the exposure and the applicable CCF".

(2) Section 227(1), definition of ***gain-on-sale***—

Repeal

"core capital"

Substitute

"CET1 capital".

120. Section 230 amended (measures which may be taken by Monetary Authority if originating institution provides implicit support)

(1) Section 230(2)—

Repeal paragraph (c)

Substitute

"(c) by notice in writing given to the institution, advise the institution that the Monetary Authority is considering exercising the power under section 97F of the Ordinance to vary the institution's capital adequacy ratio by increasing all or any of the following—

(i) the institution's CET1 capital ratio;

(ii) the institution's Tier 1 capital ratio;

(iii) the institution's Total capital ratio;".

(2) Section 230(5)—

Repeal

"101"

Substitute

"97F".

121. Section 232 amended (provisions applicable to ECAI issue specific ratings in addition to those applicable under Part 4)

(1) Section 232(d)(i)—

Repeal

"provided"

Substitute

"subject to section 232A(2) and (3), provided".

(2) Section 232(e)—

Repeal

"if"

Substitute

"subject to section 232A(2) and (3), if".

122. Section 232A added

Part 7, Division 2, after section 232—

Add

"**232A. Recognized guarantees and recognized credit derivative contracts**

(1) Subject to subsections (2) and (3)—

(a) a guarantee that falls within section 98 constitutes a recognized guarantee under this Part in relation to a securitization exposure of an authorized institution; and

(b) a credit derivative contract that falls within section 99 constitutes a recognized credit derivative contract under this Part in relation to a securitization exposure of an authorized institution.

(2) Where an authorized institution uses the STC(S) approach, for the purposes of—

(a) section 232(d) and (e) (where the credit protection mentioned in that section is provided to a securitization exposure);

(b) section 232(f);

(c) section 243(2)(b) (where the underlying exposures mentioned in that section are securitization exposures); and

(d) section 247,

sections 98(a)(vi) and 99(1)(b)(vi) are deemed to read as—

"(vi) a corporate incorporated outside India that—

(A) has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1, 2 or 3; and

(B) had an ECAI issuer rating at the time the credit protection was given that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2;

(via) a corporate incorporated in India that—

(A) has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1, 2 or 3 or, if mapped to the scale of credit quality grades in Part 2 of that Table, would result in the corporate being assigned a credit quality grade of 1, 2, 3 or 4; and

(B) had an ECAI issuer rating at the time the credit protection was given that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2 or, if mapped to the scale of credit quality grades in Part 2 of that Table, would result in the corporate being assigned a credit quality grade of 1, 2 or 3,".

(3) Where an authorized institution uses the IRB(S) approach, for the purposes of—

(a) section 232(d) and (e) (where the credit protection mentioned in that section is provided to a securitization exposure);

(b) section 232(f);

(c) section 255(2)(b) (where the underlying exposures mentioned in that section are securitization exposures);

(d) section 265;

(e) section 278; and

(f) section 279,

sections 98(a)(vi) and 99(1)(b)(vi) are deemed to read as—

"(vi) a corporate incorporated outside India—

(A) that—

(I) has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1, 2 or 3; and

(II) had an ECAI issuer rating at the time the credit protection was given that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2; or

(B) that—

(I) has an exposure assessed under the institution's rating system with an estimate of PD that is equivalent to the PD of an exposure with a credit quality grade of 1, 2 or 3 in Part 1 of Table C in Schedule 6; and

(II) had an exposure assessed under the institution's rating system at the time the credit protection was given with an estimate of PD that was equivalent to the PD of an exposure with a credit quality grade of 1 or 2 in Part 1 of Table C in Schedule 6;

(via) a corporate incorporated in India—

(A) that—

(I) has an ECAI issuer rating that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1, 2 or 3 or, if mapped to the scale of credit quality grades in Part 2 of that Table, would result in the corporate being assigned a credit quality grade of 1, 2, 3 or 4; and

(II) had an ECAI issuer rating at the time the credit protection was given that, if mapped to the scale of credit quality grades in Part 1 of Table C in Schedule 6, would result in the corporate being assigned a credit quality grade of 1 or 2 or, if mapped to the scale of credit quality grades in Part 2 of that Table, would result in the corporate being assigned a credit quality grade of 1, 2 or 3; or

(B) that—

(I) has an exposure assessed under the institution's rating system with an estimate of PD that is equivalent to the PD of an exposure with a credit quality grade of 1, 2 or 3 in Part 1 of Table C in Schedule 6 or a credit quality grade of 1, 2, 3 or 4 in Part 2 of that Table; and

(II) had an exposure assessed under the institution's rating system at the time the credit protection was given with an estimate of PD that was equivalent to the PD of an exposure with a credit quality grade of 1 or 2 in Part 1 of Table C in Schedule 6 or a credit quality grade of 1, 2 or 3 in Part 2 of that Table,".

123. Section 236 amended (deductions from core capital and supplementary capital)

(1) Section 236, heading—

Repeal

"**Deductions from core capital and supplementary capital**"

Substitute

"**Allocation of risk-weight of 1250% to certain items**".

(2) Section 236(1)—

Repeal

"Subject to subsection (2), an authorized institution shall deduct from any of its core capital and supplementary capital"

Substitute

"An authorized institution must allocate a risk-weight of 1250% to".

(3) Section 236(1)—

Repeal paragraph (b).

(4) Section 236(1)(d)(iv), after "facility;"—

Add

"and".

(5) Section 236(1)(da)—

Repeal

"exposure; and"

Substitute

"exposure.".

(6) Section 236(1)—

Repeal paragraph (e).

(7) Section 236—

Repeal subsection (2).

124. Section 236A added

After section 236—

Add

"**236A. Deduction of from CET1 capital**

"(1) An authorized institution must deduct from its CET1 capital any gain-on-sale arising from a securitization transaction if the institution is the originating institution.

(2) If the Monetary Authority, by notice in writing given to an authorized institution under section 43(1)(f), requires the institution to deduct from its CET1 capital a securitization exposure of the institution specified in the notice, the institution must make the deduction based on—

(a) the principal amount (after deduction of specific provisions) of the securitization exposure if the exposure is an on-balance sheet exposure; or

(b) the credit equivalent amount of the securitization exposure if the exposure is an off-balance sheet exposure.".

125. Section 237 amended (determination of risk-weights)

(1) Section 237(1)(a)—

Repeal

"or determining whether the exposures are to be deducted from the institution's core capital and supplementary capital,".

(2) Section 237(1)(b)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(3) Section 237(2)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(4) Section 237(2)(a)(ii)—

Repeal

"deduct the exposures from the institution's core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1250% to the exposures".

(5) Section 237(2)—

Repeal Table 24

Substitute

"**Table 24**

Risk-weights Applicable to Long-term Credit Quality Grades under STC(S) Approach (Excluding Re-securitization Exposures)

Long-term credit quality grade	Risk-weight
1	20%
2	50%
3	100%
4	350% (for investing institutions)
	1250% (for originating institutions)
5	1250%".

(6) Section 237(3)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(7) Section 237(3)—

Repeal Table 25

Substitute

"**Table 25**

Risk-weights Applicable to Short-term Credit Quality Grades under STC(S) Approach (Excluding Re-securitization Exposures)

Short-term credit quality grade	Risk-weight
1	20%
2	50%
3	100%
4	1250%".

(8) Section 237(4)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(9) Section 237(4)(a)(ii)—

Repeal

"deduct the exposures from the institution's core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1250% to the exposures".

(10) Section 237(4)—

Repeal Table 25A

Substitute

"**Table 25A**

Risk-weights Applicable to Long-term Credit Quality Grades under STC(S) Approach (Re-securitization Exposures)

Long-term credit quality grade	Risk-weight
1	40%
2	100%
3	225%
4	650% (for investing institutions)
	1250% (for originating institutions)
5	1250%".

(11) Section 237(5)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(12) Section 237(5)—

Repeal Table 25B

Substitute

"**Table 25B**

Risk-weights Applicable to Short-term Credit Quality Grades under STC(S) Approach (Re-securitization Exposures)

Short-term credit quality grade	Risk-weight
1	40%
2	100%
3	225%
4	1250%".

126. Section 238 amended (most senior tranche in securitization transaction)

Section 238(3)—

Repeal

"deduct the securitization position referred to in subsection (1) from its core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1250% to the securitization position mentioned in subsection (1)".

127. Section 240 amended (treatment of liquidity facilities and servicer cash advance facilities)

(1) Section 240(2)(a)(i)—

Repeal

"facility, or whether that undrawn portion is to be deducted from the institution's core capital and supplementary capital,"

Substitute

"facility".

(2) Section 240(2)(a)(iii)—

Repeal

"or, if deduction referred to that subparagraph is required, make the deduction".

(3) Section 240(4)—

Repeal

"deduct the undrawn portion of the facility from the institution's core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1250% to the undrawn portion of the facility".

(4) Section 240(5)(a)—

Repeal

"facility, or whether that drawn portion is to be deducted from the institution's core capital and supplementary capital,"

Substitute

"facility".

(5) Section 240(5)(c)—

Repeal

"deduct the drawn portion of the facility from the institution's core capital and supplementary capital"

Substitute

"allocate a risk-weight of 1250% to the drawn portion of the facility".

128. Section 243 amended (treatment of underlying exposures of originating institution in synthetic securitization transactions)

(1) Section 243(3)(a)—

Repeal

"paragraphs (b) and (c)"

Substitute

"paragraph (b)".

(2) Section 243(3)(a), after "modifications;"—

Add

"and".

(3) Section 243(3)(b)(ii)—

Repeal

"and (4); and"

Substitute

"and (4).".

(4) Section 243(3)—

Repeal paragraph (c).

129. Section 250 amended (application of scaling factor)

Section 250(b)—

Repeal

"224"

Substitute

"224(1)".

130. Section 251 amended (deductions from core capital and supplementary capital)

(1) Section 251, heading—

Repeal

"**Deductions from core capital and supplementary capital**"

Substitute

"**Allocation of risk-weight of 1250% to certain items**".

(2) Section 251(1)—

Repeal

"Subject to subsection (2), an authorized institution shall deduct from any of its core capital and supplementary capital"

Substitute

"An authorized institution must allocate a risk-weight of 1250% to".

(3) Section 251(1)—

Repeal paragraph (b).

(4) Section 251(1)—

Repeal paragraph (d).

(5) Section 251(1)—

Repeal paragraph (f)

Substitute

"(f) any liquidity facility or servicer cash advance facility as required in section 264 or 277, as the case requires.".

(6) Section 251—

Repeal subsection (2).

131. Section 251A added

After section 251—

Add

"**251A. Deduction from CET1 capital**

"(1) An authorized institution must deduct from its CET1 capital any gain-on-sale arising from a securitization transaction if the institution is the originating institution.

(2) If the Monetary Authority, by notice in writing given to an authorized institution under section 43(1)(f), requires the institution to deduct from its CET1 capital a securitization exposure of the institution specified in the notice, the institution must make the deduction based on—

(a) the principal amount (after deduction of specific provisions, partial write-off or non-refundable purchase price discount, as the case may be) of the securitization exposure if the exposure is an on-balance sheet exposure; or

(b) the credit equivalent amount of the securitization exposure if the exposure is an off-balance sheet exposure.".

132. Section 255 amended (treatment of underlying exposures of originating institution in synthetic securitization transactions)

(1) Section 255(3)(a)—

Repeal

"paragraphs (b) and (c)"

Substitute

"paragraph (b)".

(2) Section 255(3)(a), after "modifications;"—

Add

"and".

(3) Section 255(3)(b)(ii)—

Repeal

"and (4); and"

Substitute

"and (4).".

(4) Section 255(3)—

Repeal paragraph (c).

133. Section 262 amended (determination of risk-weights)

(1) Section 262(1)(a)—

Repeal

"or determining whether the exposures are to be deducted from the institution's core capital and supplementary capital,".

(2) Section 262(1)(b)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(3) Section 262(4)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(4) Section 262(4)—

Repeal Table 26

Substitute

"**Table 26**

Risk-weights Applicable to Long-term Credit Quality Grades under Ratings-based Method (Excluding Re-securitization Exposures)

Long-term credit quality grade	Risk-weight		
	A	B	C
1	7%	12%	20%
2	8%	15%	25%
3	10%	18%	35%
4	12%	20%	35%
5	20%	35%	35%
6	35%	50%	50%
7	60%	75%	75%
8	100%	100%	100%
9	250%	250%	250%
10	425%	425%	425%
11	650%	650%	650%
12	1250%	1250%	1250%".

(5) Section 262(8)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(6) Section 262(8)—

Repeal Table 27

Substitute

"**Table 27**

Risk-weights Applicable to Short-term Credit Quality Grades under Ratings-based Method (Excluding Re-securitization Exposures)

Short-term credit quality grade	Risk-weight		
	A	B	C
1	7%	12%	20%
2	12%	20%	35%
3	60%	75%	75%
4	1250%	1250%	1250%".

(7) Section 262(10)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(8) Section 262(10)—

Repeal Table 27A

Substitute

"**Table 27A**

Risk-weights Applicable to Long-term Credit Quality Grades under Ratings-based Method (Re-securitization Exposures)

Long-term credit quality grade	Risk-weight of senior re-securitization exposures A	Risk-weight of non-senior re-securitization exposures B
1	20%	30%
2	25%	40%
3	35%	50%
4	40%	65%
5	60%	100%
6	100%	150%
7	150%	225%
8	200%	350%
9	300%	500%
10	500%	650%
11	750%	850%
12	1250%	1250%".

(9) Section 262(11)—

Repeal

"to, or deduct from the institution's core capital and supplementary capital,"

Substitute

"to".

(10) Section 262(11)—

Repeal Table 27B

Substitute

"**Table 27B**

Risk-weights Applicable to Short-term Credit Quality Grades under Ratings-based Method (Re-securitization exposures)

Short-term credit quality grade	Risk-weight of senior re-securitization exposures A	Risk-weight of non-senior re-securitization exposures B
1	20%	30%
2	40%	65%
3	150%	225%
4	1250%	1250%".

134. Section 264 amended (calculation of risk-weighted amount of liquidity facilities)

(1) Section 264(1)(a)—

Repeal

"facility, or whether that undrawn portion is to be deducted from the institution's core capital and supplementary capital,"

Substitute

"facility".

(2) Section 264(1)(b), after "portion;"—

Add

"and".

(3) Section 264(1)(c)—

Repeal

"paragraph (a); and"

Substitute

"paragraph (a).".

(4) Section 264(1)—

Repeal paragraph (d).

(5) Section 264(2)(a)—

Repeal

"facility, or whether that drawn portion is to be deducted from the institution's core capital and supplementary capital,"

Substitute

"facility".

(6) Section 264(2)(a), after "subsection (1)(a);"—

Add

"and".

(7) Section 264(2)(b)—

Repeal

"paragraph (a); and"

Substitute

"paragraph (a).".

(8) Section 264(2)—

Repeal paragraph (c).

135. Section 265 amended (recognized credit risk mitigation)

(1) Section 265(b)—

Repeal

"51(1)" (wherever appearing)

Substitute

"232A".

(2) Section 265(c)—

Repeal

"(2) and (4), wherever applicable,"

Substitute

"(2)(a) and (4)".

136. Section 270 amended (use of supervisory formula)

(1) Section 270(1)—

Repeal

"(3), (4) and (5),"

Substitute

"(3) and (4),".

(2) Section 270—

Repeal subsection (5).

137. Section 271 amended (capital charge factor for underlying exposures under IRB approach)

(1) Section 271(1)(a), Chinese text—

Repeal

"資本要求" (wherever appearing)

Substitute

"資本要求及 EL 數額的和".

(2) Section 271(c)(ii)—

Repeal

everything after "discount"

Substitute

"in respect of the underlying exposure, as the case may be, may be used to reduce the capital charge for the securitization exposure concerned that is subject to an effective risk-weight of 1250%.".

138. Section 272 amended (credit enhancement level of tranche)

(1) Section 272(1)(a)—

Repeal

"relevant amounts of all securitization positions"

Substitute

"outstanding amounts of all tranches".

(2) Section 272(1)(b)(ii)—

Repeal

"realized or held by the institution".

(3) Section 272(1)—

Repeal paragraph (c)

Substitute

"(c) subject to paragraph (d), if any interest rate contract or exchange rate contract in the securitization transaction ranks junior for payment to the tranche concerned, the institution may use the current exposure of the contract to calculate L;".

(4) Section 272—

Repeal subsection (2).

139. Section 273 amended (thickness of tranche)

(1) Section 273(1)(a)—

Repeal

"relevant amount of that tranche of the transaction to the EAD"

Substitute

"nominal amount of that tranche of the transaction to the nominal amount".

(2) Section 273(1)—

Repeal paragraph (b)

Substitute

"(b) for the purposes of paragraph (a), if the tranche or any underlying exposure concerned is an exposure arising from an interest rate contract or exchange rate contract, the institution must—

(i) if the current exposure of the contract is not negative, determine the nominal amount of the exposure arising from the contract as the sum of the current exposure and the potential exposure of the contract;

(ii) if the current exposure of the contract is negative, determine the nominal amount of the exposure arising from the contract as only the potential exposure of the contract.".

(3) Section 273—

Repeal subsection (2)

Substitute

"(2) To avoid doubt, an authorized institution that has an IMM(CCR) approval for OTC derivative transactions must comply with subsection (1)(b), in determining the nominal amount of the exposure arising from an OTC derivative transaction, as if it did not have that approval for those transactions.".

140. Section 275 amended (exposure-weighted average LGD)

Section 275(b), Chinese text—

Repeal

"有關風險"

Substitute

"證券化類別風險".

141. Section 277 amended (calculation of risk-weighted amount of liquidity facilities)

(1) Section 277—

Repeal subsection (2).

(2) Section 277(3)—

Repeal paragraphs (c) and (d)

Substitute

"(c) multiply the risk-weight determined in accordance with paragraph (a) by the credit equivalent amount calculated in accordance with paragraph (b).".

(3) Section 277(4)—

Repeal

"facility, or whether that undrawn portion is to be deducted from the institution's core capital and supplementary capital, in accordance with subsections (1)(a) and (b) and (2)."

Substitute

"facility in accordance with subsection (1)(a) and (b).".

(4) Section 277(5)—

Repeal

"deduct the credit equivalent amount of the undrawn portion of the facility from the institution's core capital and supplementary capital."

Substitute

"allocate a risk-weight of 1250% to the credit equivalent amount of the undrawn portion of the facility.".

(5) Section 277(6A)—

Repeal

"facility, or whether that drawn portion is to be deducted from the institution's core capital and supplementary capital, in accordance with subsections (1)(a) and (2)."

Substitute

"facility in accordance with subsection (1)(a).".

(6) Section 277—

Repeal subsection (7).

142. Section 278 amended (treatment of recognized credit risk mitigation—full credit protection)

(1) Section 278(b)—

Repeal

"51(1)" (wherever appearing)

Substitute

"232A".

(2) Section 278(c)(i)—

Repeal

"(2) and (4), where applicable,"

Substitute

"(2)(a) and (4)".

143. Section 279 amended (treatment of recognized credit risk mitigation—partial credit protection)

Section 279(1)(a)—

Repeal

"51(1)" (wherever appearing)

Substitute

"232A".

144. Section 283 amended (positions to be used to calculate market risk)

Section 283(2)—

Repeal paragraphs (a) and (b)

Substitute

"(a) a recognized credit derivative contract (within the meaning of section 51(1), 105, 139(1) or 232A, as the case requires) booked in the institution's trading book as a hedge to a credit exposure booked in the institution's banking book;

(b) an exposure that under Division 4 of Part 3 is required to be deducted from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital; or

(c) an eligible CVA hedge (within the meaning of section 226A).".

145. Section 287A amended (calculation of market risk capital charge for specific risk for interest rate exposures that fall within section 286(a)(ii))

(1) Section 287A(1)—

Repeal

"(2), (3), (4), (5), (6), (7), (8), (9), (10) and (11)"

Substitute

"(2) and (3)".

(2) Section 287A(3), after "subsections"—

Add

"(3A),".

(3) After section 287A(3)—

Add

"(3A) For the purposes of subsection (3), an authorized institution must, in relation to its securitization exposures referred to in subsection (1) —

(a) subject to paragraph (b), allocate a market risk capital charge factor of 100% to the exposures where they fall within any of the descriptions of exposures in sections 236(1)(a), (c), (d) and (da) and 251(a), (c), (e), (ea) and (f); and

(b) deduct from its CET1 capital a securitization exposure of the institution specified in any notice in writing given to the institution by the Monetary Authority under section 43(1)(f).".

(4) Section 287A—

Repeal subsection (5)

Substitute

"(5) For the purposes of subsection (3), an authorized institution must, subject to subsection (3A)(b), calculate the market risk capital charge for its positions (whether long or short) in rated securitization exposures to which a credit quality grade has been assigned in accordance with Part 7 by multiplying the positions by the appropriate market risk capital charge factors as specified in subsection (3A)(a), (6), (7), (8) or (9), as appropriate.".

(5) Section 287A(6)—

Repeal Tables 28A and 28B

Substitute

"**Table 28A**

Market Risk Capital Charge Factors for Specific Risk Applicable to Long-term Credit Quality Grades under STC(S) Approach (Excluding Re-securitization Exposures)

Long-term credit quality grade	Market risk capital charge factor
1	1.6%
2	4.0%
3	8.0%
4	28% (for investing institutions)
	100% (for originating institutions)
5	100%

Table 28B

Market Risk Capital Charge Factors for Specific Risk Applicable to Short-term Credit Quality Grades under STC(S) Approach (Excluding Re-securitization Exposures)

Short-term credit quality grade	Market risk capital charge factor
1	1.6%
2	4.0%
3	8.0%
4	100%".

(6) Section 287A(7)—

Repeal Tables 28C and 28D

Substitute

"**Table 28C**

Market Risk Capital Charge Factors for Specific Risk Applicable to Long-term Credit Quality Grades under STC(S) Approach (Re-securitization Exposures)

Long-term credit quality grade	Market risk capital charge factor
1	3.2%
2	8.0%
3	18.0%

Long-term credit quality grade	Market risk capital charge factor
4	52% (for investing institutions)
	100% (for originating institutions)
5	100%

Table 28D

Market Risk Capital Charge Factors for Specific Risk Applicable to Short-term Credit Quality Grades under STC(S) Approach (Re-securitization Exposures)

Short-term credit quality grade	Market risk capital charge factor
1	3.2%
2	8.0%
3	18.0%
4	100%".

(7) Section 287A(8)—

Repeal Tables 28E and 28F

Substitute

"**Table 28E**

Market Risk Capital Charge Factors for Specific Risk Applicable to Long-term Credit Quality Grades under Ratings-based Method

in IRB(S) Approach (Excluding Re-securitization Exposures)

Long-term credit quality grade	Market risk capital charge factor		
	A	B	C
1	0.56%	0.96%	1.60%
2	0.64%	1.20%	2.00%
3	0.80%	1.44%	2.80%
4	0.96%	1.60%	2.80%
5	1.60%	2.80%	2.80%
6	2.80%	4.00%	4.00%
7	4.80%	6.00%	6.00%
8	8.00%	8.00%	8.00%
9	20.00%	20.00%	20.00%
10	34.00%	34.00%	34.00%
11	52.00%	52.00%	52.00%
12	100%	100%	100%

Table 28F

Market Risk Capital Charge Factors for Specific Risk Applicable to Short-term Credit Quality Grades under Ratings-based Method in IRB(S) Approach (Excluding Re-securitization Exposures)

Short-term credit quality grade	Market risk capital charge factor		
	A	B	C
1	0.56%	0.96%	1.60%
2	0.96%	1.60%	2.80%
3	4.80%	6.00%	6.00%
4	100%	100%	100%".

(8) Section 287A(9)—

Repeal Tables 28G and 28H

Substitute

"**Table 28G**

Market Risk Capital Charge Factors for Specific Risk Applicable to Long-term Credit Quality Grades under Ratings-based Method in IRB(S) Approach (Re-securitization Exposures)

Long-term credit quality grade	Market risk capital charge factor	
	Senior re-securitization positions A	Non-senior re-securitization positions B
1	1.60%	2.40%
2	2.00%	3.20%
3	2.80%	4.00%
4	3.20%	5.20%

Long-term credit quality grade	Market risk capital charge factor	
	Senior re-securitization positions A	Non-senior re-securitization positions B
5	4.80%	8.00%
6	8.00%	12.00%
7	12.00%	18.00%
8	16.00%	28.00%
9	24.00%	40.00%
10	40.00%	52.00%
11	60.00%	68.00%
12	100%	100%

Table 28H

Market Risk Capital Charge Factors for Specific Risk Applicable to Short-term Credit Quality Grades under Ratings-based Method in IRB(S) Approach (Re-securitization Exposures)

Short-term credit quality grade	Market risk capital charge factor	
	Senior re-securitization positions A	Non-senior re-securitization positions B

	Market risk capital charge factor	
Short-term credit quality grade	Senior re-securitization positions A	Non-senior re-securitization positions B
1	1.60%	2.40%
2	3.20%	5.20%
3	12.00%	18.00%
4	100%	100%".

(9) Section 287A(10)—

Repeal

"subsection (11)"

Substitute

"subsections (3A) and (11)".

(10) After section 287A(11)—

Add

"(12) To avoid doubt, the credit risk mitigation treatment specified in Part 7 does not apply in relation to an authorized institution's calculation of market risk capital charge for specific risk interest rate exposures mentioned in subsection (1).".

146. Section 307 amended (specific risk)

Section 307(5)(b)—

Repeal

"position, or deduct the position from the core capital and supplementary capital of the institution,"

Substitute

"position".

147. Section 313 amended (counterparty credit risk)

Section 313—

Repeal subsection (5)

Substitute

"(5) To avoid doubt—

(a) there is no counterparty credit risk for an authorized institution as the purchaser or issuer of a credit-linked note;

(b) an authorized institution must use the current exposure method or the IMM(CCR) approach, as the case requires, to calculate its default risk exposures arising from credit derivative contracts booked in its trading book; and

(c) an authorized institution must calculate the CVA capital charge in respect of credit derivative contracts booked in its trading book in accordance with Part 6A.".

148. Section 316 amended (positions to be used to calculate market risk)

Section 316(2)—

Repeal paragraphs (a) and (b)

Substitute

"(a) a recognized credit derivative contract (within the meaning of section 51(1), 105, 139(1) or 232A, as the

case requires) booked in the institution's trading book as a hedge to a credit exposure booked in the institution's banking book;

(b) an exposure that under Division 4 of Part 3 is required to be deducted from any of the institution's CET1 capital, Additional Tier 1 capital and Tier 2 capital; or

(c) an eligible CVA hedge (within the meaning of section 226A).".

149. Section 318 amended (capital treatment for trading book positions subject to incremental risk charge or comprehensive risk charge)

Section 318(4)(a)—

Repeal

"the market risk capital charge for general market risk and".

150. Section 321 amended (counterparty credit risk)

Section 321—

Repeal subsection (5)

Substitute

"(5) To avoid doubt—

(a) there is no counterparty credit risk for an authorized institution as the purchaser or issuer of a credit-linked note;

(b) an authorized institution must use the current exposure method or the IMM(CCR) approach, as the case requires, to calculate its default risk exposures arising from credit derivative contracts booked in its trading book; and

(c) an authorized institution must calculate the CVA capital charge in respect of credit derivative contracts booked in its trading book in accordance with Part 6A.".

151. Schedule 1 amended (specifications for purposes of certain definitions in section 2(1) of these Rules)

(1) Schedule 1, heading—

Repeal

"**Section 2(1) of**".

(2) Schedule 1, after "[ss. 2, 73, 120,"—

Add

"157A,".

(3) Schedule 1, after Part 10—

Add

"**Part 11**

Main Business of Unregulated Financial Institutions".

152. Schedule 1A added

After Schedule 1—

Add

"**Schedule 1A** [s. 226N]

Transactions and Contracts not Subject to CVA Capital Charge

1. OTC derivative transactions, credit derivative contracts and SFTs with a CCP where the authorized institution concerned is a clearing member of the CCP;

2. OTC derivative transactions, credit derivative contracts and SFTs with a clearing member of a CCP that fall within section 226ZA(3), (4) or (5) where the authorized institution concerned is a client of the clearing member;

3. OTC derivative transactions, credit derivative contracts and SFTs with a CCP that fall within section 226ZB(2), (3) or (4) where the authorized institution concerned is a client of a clearing member of the CCP; and

4. Recognized credit derivative contracts purchased by an authorized institution to provide credit protection to the institution's banking book exposures where the exposures are not subject to the CVA capital charge and the contracts are not treated as recognized credit derivative contracts or eligible CVA hedges for any other exposures of the institution.".

153. Schedule 2 amended (minimum requirements to be satisfied for approval under section 8 of these Rules to use IRB approach)

Schedule 2, section 1(b)(viii)—

Repeal

"any rules made by the Monetary Authority under section 60A of the Ordinance as amended by the Banking (Amendment) Ordinance 2005 (19 of 2005)"

Substitute

"the Banking (Disclosure) Rules (Cap. 155 sub. leg. M)".

154. Schedule 2A added

After Schedule 2—

Add

"**Schedule 2A** [ss. 10B, 10D, 226D & 226Q]

Minimum Requirements to be Satisfied for Approval under Section 10B(2)(a) of These Rules to Use IMM(CCR) Approach

1. General requirements

An authorized institution that makes an application under section 10B(1) of these Rules to use the IMM(CCR) approach must demonstrate to the satisfaction of the Monetary Authority that—

(a) the board of directors (or a committee designated by the board) and the senior management of the institution—

(i) approve all the key elements of, and any material changes to, the institution's counterparty credit risk management system (being the methods, models, processes, controls, and data collection and information technology systems used by the institution that enable the identification, measurement, management and control of counterparty credit risk by the institution);

(ii) possess an understanding of the design and operation of, and the management reports generated by, the institution's counterparty credit risk management system adequate for them to perform their functions specified in this paragraph;

(iii) exercise oversight of the institution's counterparty credit risk management system sufficient to ensure that the system complies with paragraph (b); and

(iv) ensure that there is a reporting system within the institution to provide information (including information relating to any material changes to, or deviations from, established policies and procedures or any material findings identified in a review or audit referred to in paragraph (k)) to them regularly and in sufficient detail as will enable them to—

(A) exercise the oversight referred to in subparagraph (iii); and

(B) make informed decisions relating to the institution's counterparty credit risk exposures;

(b) the institution's counterparty credit risk management system—

(i) is suitable for the purposes of identifying, measuring, managing, controlling and reporting the institution's counterparty credit risk taking into account the characteristics and extent of the institution's counterparty credit risk exposures;

(ii) identifies, measures, monitors and controls counterparty credit risk over the life of transactions;

(iii) measures and manages both current exposures (gross and net of collateral held, where appropriate) and future exposures; and

(iv) is operated in a prudent and consistently effective manner that is also consistent with sound practices for counterparty credit risk management;

(c) the institution—

(i) clearly documents the counterparty credit risk management system and the internal policies, controls and procedures relating to the operation of the system, including—

(A) the internal models to which the application relates (referred to in this Schedule as ***relevant models***);

(B) the calculation of the risk measures generated by the relevant models with sufficient details for a third party to re-create the risk measures; and

(C) the model validation process, including frequency and methodologies of validation and analyses used; and

(ii) has a system for monitoring and ensuring compliance with those internal policies, controls and procedures;

(d) the institution has a risk control unit—

(i) that is functionally independent of the institution's staff and management

responsible for originating counterparty credit risk exposures;

(ii) that reports directly to the institution's senior management;

(iii) that is responsible for—

(A) the design or selection of the institution's counterparty credit risk management system;

(B) the testing, validation and implementation of the institution's counterparty credit risk management system;

(C) the oversight of the effectiveness of the institution's counterparty credit risk management system for the purposes of paragraph (b), including the control of data integrity;

(D) the production and analysis of daily management reports on the output of the relevant models, including an evaluation of the relationship between measures of counterparty credit risk exposure and credit and trading limits;

(E) the ongoing review of, and changes to, the institution's counterparty credit risk management system; and

(F) the conduct of a regular back-testing programme to verify the accuracy and reliability of the relevant models;

(iv) the work of which is an integral part of the day-to-day credit risk management process of

the institution, including the planning, monitoring and controlling of the institution's credit and overall risk profile; and

(v) the daily management reports of which are reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual traders and reductions in the institution's overall risk exposure;

(e) the institution has a collateral management unit—

(i) that is adequately staffed and with sufficient resources to process margin calls and disputes in a timely and accurate manner at all times (including during periods of severe market crisis), and to enable the institution to limit its number of large disputes caused by trade volumes; and

(ii) that is responsible for—

(A) calculating and making margin calls, managing margin call disputes and reporting levels of independent amounts, initial margins and variation margins accurately on a daily basis;

(B) controlling the integrity of the data used to make margin calls and ensuring that such data are consistent and reconciled regularly with all relevant data sources within the institution;

(C) tracking the extent of reuse of collateral posted to the institution (both cash and non-cash) and the rights ceded by the

institution in respect of the collateral that it posts;

(D) tracking concentration in individual types of collateral accepted by the institution; and

(E) producing and maintaining appropriate collateral management information (including information on the type of collateral (cash and non-cash) received and posted, categories of collateral reused and the terms of the reuse, the size, aging and cause of margin call disputes, and the trends in the areas to which such information relates) and reporting the information to the institution's senior management on a regular basis;

(f) the institution has a sufficient number of staff who are qualified and trained to use the relevant models in the institution's business, risk control, audit and back office functions as will enable those functions to work prudently and effectively in identifying, measuring, managing, controlling and reporting the institution's counterparty credit risk;

(g) the use of the relevant models is part of the institution's counterparty credit risk management system and plays an essential role in the institution's daily risk management, capital planning and corporate governance functions, with—

(i) the results generated by the relevant models being used in—

(A) planning, measuring, monitoring and controlling the institution's counterparty credit risk exposures;

(B) determining the institution's trading and credit risk exposure limits and measuring the usage of those limits;

(C) credit approval; and

(D) internal capital allocation; and

(ii) the relationship between the relevant models and the limits mentioned in subparagraph (i)(B) being maintained consistently over time and understood by the institution's senior management, credit function and staff engaged in trading activity;

(h) the institution—

(i) uses stress-testing and scenario analysis to identify risk factors that give rise to general wrong-way risk and address the possibility of severe shocks;

(ii) monitors general wrong-way risk by product, by region, by industry, or by other categories that are relevant to the business of the institution;

(iii) has policies and procedures for identifying, monitoring and controlling transactions with specific wrong-way risk at the inception and throughout the life of the transactions; and

(iv) provides regular reports on wrong-way risks to its senior management and board of directors (or a committee designated by the board);

(i) the cash management policy of the institution takes account of the liquidity risks arising from potential incoming margin calls (including calls for posting of collateral due to adverse market shocks or potential downgrade of the institution's external credit rating and calls for return of collateral);

(j) the institution ensures that the nature and horizon of collateral reuse are consistent with its liquidity needs and do not jeopardize its ability to post or return collateral in a timely manner;

(k) an independent review or audit of the adequacy of the institution's counterparty credit risk management system and the institution's compliance with internal policies, controls and procedures, including the requirements specified in this Schedule, in respect of the system is conducted regularly by the institution's internal auditors or by independent external parties that are qualified to do so;

(l) the institution, before being granted an IMM(CCR) approval—

(i) has been using an internal model that is broadly consistent with the requirements set out in this Schedule to estimate the distribution of exposures (within the meaning given in section 226H(2) of these Rules) using current market data for a period (not less than one year in any case) that is considered by the Monetary Authority as reasonable in all the circumstances of the case; and

(ii) has been conducting back-testing, being back-testing that is broadly consistent with the requirements set out in this Schedule relating to back-testing, using historical data on movements in market risk factors.

2. Specific requirements relating to relevant models

Without limiting section 1, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that—

(a) the relevant models specify the forecast of the probability distribution of changes in the market value of a netting set attributable to changes in relevant market factors and calculates the institution's counterparty default risk exposure for the netting set at each future date given the changes in the market factors;

(b) the relevant models capture and accurately reflect, on a continuing basis, all material factors affecting counterparty default risk inherent in the institution's transactions;

(c) the relevant models capture transaction specific information in order to aggregate exposures at netting set level;

(d) the institution calculates counterparty default risk on the basis of a distribution of exposures that accounts for the possible non-normality of the distribution of exposures;

(e) the relevant models have a proven track record of acceptable accuracy in measuring counterparty default risk;

(f) the relevant models used for pricing options account for the non-linearity of option value with respect to market risk factors; and

(g) the relevant models are capable of estimating EE on a daily basis (unless the institution is able to otherwise demonstrate to the satisfaction of the Monetary Authority that a less frequent calculation is warranted) and the EE is estimated along a time profile of forecasting horizons that adequately reflects the time structure of future cash flows and maturity of transactions.

3. Specific requirements relating to integrity of modelling process

Without limiting sections 1 and 2, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that—

(a) transaction terms and specifications are reflected in the relevant models in a timely, complete, and conservative manner, and maintained in a secure database that is subject to formal and periodic audit;

(b) the terms and specifications of any valid bilateral netting agreements or valid cross-product netting agreements are input into the database by an independent unit;

(c) the transmission of data on transaction terms and specifications to the relevant models is subject to internal audit and the institution has formal processes for reconciliation between the relevant models and the source data systems to verify on an ongoing basis that transaction terms and

specifications are reflected in EE correctly or at least conservatively;

(d) the institution has internal procedures to verify that—

(i) before including a transaction in a netting set, the transaction is covered by a valid bilateral netting agreement or a valid cross-product netting agreement, as the case may be, and the legal enforceability of the agreement has been verified by legal staff;

(ii) before recognizing the effect of collateral in the calculation of counterparty default risk, the collateral meets the legal certainty standards set out in section 77 of these Rules;

(e) the institution, when calibrating its relevant models using historical market data—

(i) uses current market data to compute current exposures;

(ii) estimates the parameters of the models using either—

(A) at least 3 years of historical market data; or

(B) market implied data; and

(iii) updates the data quarterly, or more frequently if market conditions warrant it;

(f) for the purposes of performing the calculations mentioned in section 226D(1)(b), the institution calibrates its relevant models and estimates the parameters of the models using either—

(i) 3 years of data that include a period of stress to the credit default spreads of the institution's counterparties; or

(ii) market implied data from a suitable period of stress; and

(g) the institution adopts the following measures to ensure the adequacy of the stress calibration mentioned in paragraph (f)—

(i) the institution demonstrates, at least quarterly, that—

(A) the period of stress referred to in paragraph (f) coincides with a period of increased credit default swap spreads or other credit spreads of a representative selection of the institution's counterparties with traded credit spreads; and

(B) where adequate credit spread data for a counterparty is not available for the purposes of sub-subparagraph (A), the institution maps the counterparty to specific credit spread data based on the counterparty's geographical location, internal rating and business type;

(ii) the relevant models use data (either historical or implied) that include data from a period of credit stress and use such data in a manner that is consistent with the method used for the calibration of the relevant models to current market data; and

(iii) for the purposes of evaluating the effectiveness of its stress calibration, the

institution creates several benchmark portfolios that are vulnerable to the same main risk factors to which the institution is exposed and compares the exposures to the benchmark portfolios calculated using—

(A) current positions at current market prices, and model parameters calibrated in the manner set out in paragraph (f)(i); and

(B) current positions at market prices at the end of the 3 years mentioned in paragraph (f)(i), and model parameters calibrated in the manner set out in that paragraph.

4. Specific requirements relating to stress-testing

Without limiting sections 1, 2 and 3, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that—

(a) the institution has a comprehensive stress-testing programme for counterparty credit risk that is conducted regularly and includes the following elements—

(i) the programme comprehensively captures transactions and aggregate exposures across all forms of trading and across different product categories at the counterparty-specific level, and the time frame selected for the capturing and aggregation is commensurate with the frequency with which stress tests are conducted;

(ii) there is at least monthly stress-testing of principal market risk factors, including interest rates, exchange rates, equities prices, credit spreads and commodity prices, for all counterparties of the institution to assess and address concentration in specific directional risks;

(iii) there is at least quarterly multifactor stress-testing to assess material non-directional risks including yield curve exposures and basis risks, and the stress-testing addresses, at a minimum, the following scenarios—

(A) severe economic or market events;

(B) significant decrease in broad market liquidity; and

(C) the liquidation of a large financial intermediary;

(iv) there is at least quarterly stress-testing of joint movement of counterparty credit risk exposures and related counterparty creditworthiness;

(v) the stress tests (including those mentioned in subparagraphs (i) to (iv)) are conducted at the counterparty-specific level and the counterparty-group level (grouped by industry, region or other relevant criteria), and in aggregate at the institution-wide level;

(vi) the severity of shocks are consistent with the purpose of the stress test; and

(vii) the programme includes provision, where appropriate, for reverse stress tests to identify

extreme, but plausible, scenarios that could result in significant adverse outcomes; and

(b) the stress-testing results are—

(i) reported regularly to the institution's senior management and periodically to the institution's board of directors (or a committee designated by the board) and cover the largest counterparty-level impacts across the institution's portfolio, material segmental concentrations (within the same industry or region) and portfolio and counterparty specific trends; and

(ii) used in—

(A) managing the institution's counterparty credit risk, including the setting of policies, risk appetite and exposure limits and the identification and mitigation of excessive or concentrated risks relative to the institution's risk appetite; and

(B) performing the assessment of the adequacy of the institution's regulatory capital and internal capital for counterparty credit risk and the institution's ability to withstand any future events, or changes in economic conditions, that could have adverse effects on the institution's counterparty credit risk exposures.

5. Specific requirements relating to model validation

Without limiting sections 1, 2, 3 and 4, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that—

(a) the institution has a reliable validation system for validating the accuracy, comprehensiveness and consistency of the relevant models (including the risk measures and risk factor predictions generated by or used in the models) by parties—

(i) who are qualified and trained to do so and who are independent of the staff and management responsible for originating counterparty credit risk and the development of the relevant models; and

(ii) whose aim is to ascertain whether the relevant models are conceptually sound, able to capture all material factors affecting counterparty default risk, and continue to perform as intended;

(b) the validation referred to in paragraph (a) must meet the following requirements—

(i) the validation is conducted—

(A) when a relevant model is initially developed and thereafter regularly at a frequency that is adequate to reflect the recent performance of the model; and

(B) when any significant changes are made to a relevant model or when there have been significant structural changes in the market or changes to the composition of the institution's portfolio of exposures

that might lead to the relevant model concerned no longer being adequate to capture all material factors affecting counterparty default risk;

(ii) the validation assesses the accuracy, comprehensiveness and consistency of the relevant models in respect of the results generated by the models at both the institution-wide level and the netting set level;

(iii) the validation procedures—

(A) are clearly documented in sufficient detail as will enable a third party to evaluate the appropriateness of the procedures and re-create the analysis performed by the institution;

(B) define assessment criteria and describe the process by which unacceptable performance will be determined and remedied;

(C) ensure that the relevant models cover all factors and products that have a material contribution to counterparty default risk exposures;

(D) ensure that all counterparties for which the relevant models are used are covered by the validation;

(E) ensure that both the assumptions and approximations underlying the relevant models are prudent and appropriate for the measurement of the institution's counterparty default risk exposures; and

(F) define how representative counterparty portfolios are constructed for the purposes of the validation mentioned in paragraph (d)(v);

(c) the validation of the relevant models and the risk measures that produce forecasts of distributions assesses more than a single statistic of the distributions;

(d) as part of the initial and on-going validation process, the institution—

(i) conducts appropriate back-testing to—

(A) assess the performance of the relevant models and the risk measures and market risk factor predictions that are used to estimate EE; and

(B) test the key assumptions of the relevant models and the risk measures;

(ii) includes in back-testing—

(A) a number of distinct prediction time horizons set out to at least one year, over a range of various start dates and covering a wide range of market conditions; and

(B) for collateralized transactions, prediction time horizons that reflect typical margin periods of risk applied in such transactions and long time horizons that are at least one year;

(iii) tests the pricing models used to calculate counterparty default risk exposure for a given scenario of future shocks to market risk

factors and against appropriate independent benchmarks;

(iv) verifies that transactions are assigned to an appropriate netting set within the model;

(v) conducts static, historical back-testing on representative counterparty portfolios, with the representative counterparty portfolios chosen based on their sensitivity to the material risk factors and correlations to which the institution is exposed;

(vi) validates the relevant models and risk measures out to time horizons that are commensurate with the maturity of transactions covered by the institution's IMM(CCR) approval; and

(vii) assesses the frequency with which the parameters of the relevant models are updated; and

(e) the validation results, including those of back-testing, are reviewed periodically by a level of management with sufficient authority to decide the actions that will be taken to address any weaknesses identified in the models.

6. Additional requirements relating to relevant models that capture effects of margin agreements

Without limiting sections 1, 2, 3, 4 and 5, an authorized institution must demonstrate to the satisfaction of the Monetary Authority that, if the relevant models used by the institution capture the effects of margin agreements when estimating EE, the models—

(a) meet the requirements of sections 1 to 5 in respect of the prediction of future collateral values;

(b) include transaction-specific information in order to capture the effects of margining;

(c) take into account both the current amount of collateral and collateral that would be passed between counterparties in the future;

(d) account for the nature of margin agreements (whether the agreement concerned is unilateral or bilateral), the frequency of margin calls, the margin period of risk, the margin thresholds, and the minimum transfer amount; and

(e) either estimate the mark-to-market change in the value of collateral posted, or apply the rules for recognized collateral set out in Part 4, 5 or 6, as the case may be, of these Rules.

7. Additional requirements relating to shortcut method

Without limiting sections 1, 2, 3, 4, 5 and 6, an authorized institution that uses the shortcut method must demonstrate to the satisfaction of the Monetary Authority that—

(a) the institution's back-testing programme tests regularly whether the counterparty default risk exposures predicted by the shortcut method over all margin periods of risk within one year are consistent with the realized values of the exposures;

(b) if some of the transactions in a netting set have a maturity of less than one year and the netting set would have higher risk factor sensitivities if these transactions were removed from the netting set, this

fact will be taken into account in the back-testing and other validation processes for the method; and

(c) the institution has procedures to ensure that if the back-testing result indicates that effective EPE is underestimated, appropriate actions will be taken to make the predicted values more conservative.".

155. Schedule 3 amended (minimum requirements to be satisfied for approval under section 18 of these Rules to use IMM approach)

(1) Schedule 3, after "[ss. 18, 19, 97,"—

Add

"226Q,".

(2) Schedule 3, section 4(g)—

Repeal

"on Banking Supervision".

156. Schedules 4A to 4H added

After Schedule 4—

Add

"**Schedule 4A** [s. 2 & Schs. 4D & 4H]

Qualifying Criteria to be Met to be CET1 Capital

1. Qualifying criteria

A capital instrument (including an ordinary share) qualifies as CET1 capital of an authorized institution only if the following criteria are met—

(a) the instrument entitles the holder of the instrument to the most subordinated claim in a liquidation of the institution;

(b) the instrument entitles the holders of the instrument to a claim on the residual assets of the institution, that, in the event of its liquidation, and after the payment of all senior claims, is proportional with the holder's share of issued capital and is not fixed or subject to a cap (that is, has an unlimited and variable claim);

(c) the instrument is perpetual and the principal amount of the instrument may not be repaid outside of a liquidation (except discretionary repurchases or other discretionary means of reducing capital that is permitted under applicable law);

(d) the institution has not created, and has not done anything to create, an expectation at issuance that the instrument will be bought back, redeemed or cancelled, and there is no statutory or contractual terms that might reasonably give rise to such an expectation;

(e) for distributions to holders of the instrument—

(i) the distributions are paid only out of distributable items;

(ii) the level of distributions is not in any way tied or linked to the amount paid up at issuance;

(iii) the terms and conditions governing the instrument do not include a cap or other restrictions on the maximum level of distributions except to the extent that the

institution is unable to pay distributions that exceed the level of distributable items;

(iv) the terms and conditions governing the instrument do not include any obligation for the institution to make distributions to holders of the instrument;

(v) the non-payment of distributions does not constitute an event of default of the institution; and

(vi) there are no preferential distributions, including in respect of other CET1 capital instruments, and distributions are paid only after all legal and contractual obligations have been met and payments on more senior capital instruments have been made;

(f) the instrument takes the first and proportionately greatest share of losses as they occur (even if the institution has other capital instruments that have a permanent write-down feature outstanding), and the instrument absorbs losses on a going concern basis proportionately and pari passu with all other capital instruments issued by the institution;

(g) the paid-up amount is recognized as equity capital for the purposes of determining balance sheet insolvency;

(h) the paid-up amount is classified as equity within the meaning of applicable accounting standards;

(i) the instrument is directly issued by the institution and paid up;

(j) the institution has not directly or indirectly funded the purchase of the instrument;

(k) the paid-up amount is not secured or covered by a guarantee of the institution or by an affiliate of the institution, and is not subject to any other arrangement that legally or economically enhances the seniority of the claim;

(l) the instrument is only issued with the approval of the shareholders of the institution, either given directly by the shareholders or, if permitted by applicable law, given by the board of directors or by other persons duly authorized by the shareholders;

(m) the instrument is clearly and separately disclosed on the balance sheet in the financial statements of the institution.

Schedule 4B

[ss. 2 & 39 & Schs. 4D & 4H]

Qualifying Criteria to be Met to be Additional Tier 1 Capital

1. Qualifying criteria

A capital instrument qualifies as Additional Tier 1 capital of an authorized institution only if the following criteria are met—

(a) the instrument is issued and paid up;

(b) the instrument is subordinated to depositors, general creditors and other subordinated debt of the institution;

(c) the paid-up amount is not secured or covered by a guarantee of the institution or by an affiliate of the

institution, and is not subject to any other arrangement that legally or economically enhances the seniority of the claim;

(d) the instrument is perpetual and the terms and conditions of the instrument contain no step-ups or other incentives to redeem;

(e) if the terms and conditions of the instrument include one or more call options, any such option may only be exercised at the initiative of the issuer after at least 5 years, and—

(i) to exercise a call option, the institution must have the prior approval of the Monetary Authority;

(ii) the institution has not created, and has not done anything to create, an expectation at issuance that the call option will be exercised; and

(iii) the institution must not exercise a call option unless it—

(A) replaces the called instrument with capital of the same or better quality and the replacement of the capital is effected on conditions that are sustainable for the income capacity of the institution; or

(B) demonstrates that its capital position is above the minimum capital requirements applicable to it, and will remain to be above those requirements after the call option is exercised;

(f) any repayment of principal (whether through repurchase, redemption or otherwise) can only be

made with the prior approval of the Monetary Authority and the institution does not assume or create market expectations that the Monetary Authority's approval will be given;

(g) the dividend or coupon distributions in respect of the instrument are subject to the following—

(i) the institution has full discretion at all times to cancel the distributions on the instrument for an unlimited period and on a non-cumulative basis;

(ii) the institution has full access to cancelled payments to meet its obligations as they fall due;

(iii) the cancellation of distributions on the instrument does not constitute an event of default for the instrument; and

(iv) the cancellation of distributions on the instrument imposes no restrictions on the institution except in relation to distributions to ordinary shareholders;

(h) dividends or coupons are paid only out of distributable items;

(i) the instrument does not have a credit sensitive dividend feature such that the level of dividend or coupon to be paid is reset periodically based in whole or in part on the institution's own credit risk;

(j) the instrument does not contribute to liabilities exceeding assets of the institution if a balance sheet test forms part of national insolvency law applicable to the instrument;

(k) where the instrument is classified as a liability for accounting purposes, the instrument meets the following conditions—

(i) the terms and conditions of the instrument include a provision requiring the outstanding amount of the instrument to be written down, or converted to ordinary shares, when the CET1 capital ratio of the institution reaches—

(A) a level at or below 5.125%; or

(B) a level higher than 5.125% where determined by the institution and specified in the terms and conditions governing the instrument;

(ii) the write-down or conversion to be effected under subparagraph (i) generates equity capital under applicable accounting standards and the instrument only receives recognition in Additional Tier 1 capital up to the minimum level of CET1 capital generated by a full write-down or conversion of the instrument; and

(iii) the aggregate amount of the instrument to be written down or converted is at least the amount that can immediately return the institution's CET1 capital ratio to a level specified in subparagraph (i);

(l) for the purposes of paragraph (k), the write-down mechanism that allocates losses to the instrument when the CET1 capital ratio falls to a level specified in paragraph (k)(i) has the following effects—

(i) it reduces the claim of the holder of the instrument in a liquidation of the institution;

(ii) it reduces the amount to be re-paid when a call option is exercised; and

(iii) it partially or fully reduces dividend or coupon distributions in respect of the instrument;

(m) neither the institution nor an affiliate of the institution over which the institution exercises control or significant influence has purchased the instrument, and the institution has not directly or indirectly funded the purchase of the instrument;

(n) the instrument has no features that hinder recapitalization (for example, provisions that require the issuer to compensate holders of the instrument if a new instrument is issued at a lower price during a specified time frame);

(o) if the instrument is not issued out of an operating entity (being an entity established to conduct business with clients with a view to making a profit in its own right) or the holding company in the consolidation group (for example, the instrument is issued by a special purpose vehicle), proceeds are immediately available without limitation to an operating entity or the holding company, as the case may be, in the consolidation group in a form that meets all of the other qualifying criteria mentioned in this Schedule for inclusion in Additional Tier 1 capital; and

(p) the terms and conditions governing the instrument contain a point of non-viability provision and, in this regard, the institution ensures that—

(i) the instrument will be either written off or converted into CET1 capital on the occurrence of the trigger event;

(ii) any compensation paid to the holders of the instrument as a result of a write-off will be paid immediately in the form of ordinary shares;

(iii) the trigger event is the earlier of—

(A) the Monetary Authority notifying the institution in writing that the Monetary Authority is of the opinion that a write-off or conversion is necessary, without which the institution would become non-viable; or

(B) the Monetary Authority notifying the institution in writing that a decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the institution would become non-viable;

(iv) any new ordinary shares issued as a result of the trigger event occurs before any public sector injection of capital so that the capital provided by the public sector will not be diluted;

(v) (if the institution wishes any instrument issued by an overseas subsidiary of the institution to be included in the capital base for the purposes of calculating its

consolidated capital adequacy ratio pursuant to a section 3C requirement in addition to being included in the overseas subsidiary's solo capital adequacy ratio) the terms and conditions of the instrument specify that the Monetary Authority, in addition to the relevant authority in the jurisdiction of the overseas subsidiary, may trigger the write-down or conversion of the instrument;

(vi) (if the institution issuing the instrument is a Hong Kong subsidiary of a wider banking group and the institution wishes the instrument to be included in the consolidation group's capital adequacy ratio in addition to being included in its solo capital adequacy ratio) the terms and conditions of the instrument specify an additional trigger event, being the earlier of—

(A) the home authority notifying the parent bank of the institution in writing that the authority is of the opinion that a write-off or conversion is necessary, without which the institution or the parent bank of the institution would become non-viable; or

(B) the home authority notifying the parent bank of the institution in writing that the authority has decided that a public sector injection of capital or equivalent support, in the jurisdiction of the home authority, is necessary, without which the institution or the parent bank of the institution would become non-viable;

(vii) the institution maintains, at all times, all prior authorization necessary to immediately issue the relevant number of ordinary shares specified in the instrument's terms and conditions, and there are no impediments to the write-off or automatic conversion of the instrument into ordinary shares of the institution if the trigger event or additional trigger event occurs; and

(viii) the institution submits the following information and documents to the Monetary Authority and obtains the prior consent of the Monetary Authority before including any issuance of the instrument as Additional Tier 1 capital—

(A) if the terms and conditions of the instrument provide for trigger events in addition to the trigger events specified under this paragraph, a notice in writing to the Monetary Authority containing—

(I) the rationale for those additional trigger events; and

(II) an assessment by the institution of the possible market implications that might arise from the inclusion of those additional trigger events or on the occurrence of those additional trigger events; and

(B) a detailed description of the rationale for the specified conversion method, including computations of the indicative dilution of the institution's ordinary

shares that would occur on the occurrence of the trigger event and the resulting ordinary shareholder structure, and an explanation of why such a conversion approach would help to ensure or maintain the viability of the institution.

Schedule 4C

[ss. 2 & 40 & Schs. 4D & 4H]

Qualifying Criteria to be Met to be Tier 2 Capital

1. Qualifying criteria

A capital instrument qualifies as Tier 2 capital of an authorized institution only if the following criteria are met—

(a) the instrument is issued and paid up;

(b) the instrument is subordinated to depositors and general creditors of the institution;

(c) the paid-up amount is not secured or covered by a guarantee of the institution or by an affiliate of the institution, and is not subject to any other arrangement that legally or economically enhances the seniority of the claim;

(d) the instrument has a minimum original maturity of at least 5 years, the terms and conditions of the instrument contain no step-ups or other incentives to redeem, and the recognition of the instrument in regulatory capital in the remaining 5 years before maturity is amortized on a straight line basis of 20% per year;

(e) if the terms and conditions of the instrument include one or more call options, any such option may only be exercised at the initiative of the issuer only after at least 5 years, and—

(i) to exercise a call option, the institution must have the prior approval of the Monetary Authority;

(ii) the institution has not created, and has not done anything to create, an expectation at issuance that the call option will be exercised; and

(iii) the institution must not exercise a call option unless it—

(A) replaces the called instrument with capital of the same or better quality and the replacement of the capital is done on conditions that are sustainable for the income capacity of the institution; or

(B) demonstrates that its capital position is well above the minimum capital requirements applicable to it, and will remain to be well above those requirements after the call option is exercised;

(f) the holders of the instrument have no rights to accelerate the payment or repayment of future scheduled payments (coupon or principal) except in the event of a liquidation of the institution;

(g) the instrument does not have a credit sensitive dividend feature such that the level of dividend or coupon to be repaid is reset periodically based in

whole or in part on the institution's own credit standing;

(h) neither the institution nor an affiliate of the institution over which the institution exercises control or significant influence has purchased the instrument and the institution has not directly or indirectly funded the purchase of the instrument;

(i) if the instrument is not issued out of an operating entity (being an entity established to conduct business with clients with a view to making a profit in its own right) or the holding company in the consolidation group (for example, the instrument is issued by a special purpose vehicle), proceeds are immediately available without limitation to the operating entity or the holding company, as the case may be, in the consolidation group in a form which meets all of the other qualifying criteria mentioned in this Schedule for inclusion in Tier 2 capital; and

(j) the terms and conditions governing the instrument contain a point of non-viability provision and, in this regard, the institution ensures that—

(i) the instrument will be either written off or converted into CET1 capital on the occurrence of the trigger event;

(ii) any compensation paid to the holders of the instrument as a result of a write-off will be paid immediately in the form of ordinary shares;

(iii) the trigger event is the earlier of—

(A) the Monetary Authority notifying the institution in writing that the

Monetary Authority is of the opinion that a write-off or conversion is necessary, without which the institution would become non-viable; or

(B) the Monetary Authority notifying the institution in writing that a decision has been made by the government body, a government officer or other relevant regulatory body with the authority to make such a decision, that a public sector injection of capital or equivalent support is necessary, without which the institution would become non-viable;

(iv) any new ordinary shares issued as a result of the trigger event occurs before any public sector injection of capital so that the capital provided by the public sector will not be diluted;

(v) (if the institution wishes any instrument issued by an overseas subsidiary of the institution to be included in the capital base for the purposes of calculating its consolidated capital adequacy ratio pursuant to a section 3C requirement in addition to the overseas subsidiary's solo capital adequacy ratio) the terms and conditions of the instrument specify that the Monetary Authority, in addition to the relevant authority in the jurisdiction of the overseas subsidiary,

may trigger the write-down or conversion of the instrument;

(vi) (if the institution issuing the instrument is a Hong Kong subsidiary of a wider banking group and the institution wishes the instrument to be included in the consolidation group's capital adequacy ratio in addition to being included in its solo capital adequacy ratio) the terms and conditions of the instrument specify an additional trigger event, being the earlier of—

(A) the home authority notifying the parent bank of the institution in writing that the authority is of the opinion that a write-off or conversion is necessary, without which the institution or the parent bank of the institution would become non-viable; or

(B) the home authority notifying the parent bank of the institution in writing that the authority has decided that a public sector injection of capital or equivalent support, in the jurisdiction of the home authority, is necessary, without which the institution or the parent bank of the institution would become non-viable;

(vii) the institution maintains, at all times, all prior authorization necessary to immediately issue the relevant number of ordinary shares specified in the instrument's terms and

conditions and there are no impediments to the write-off or automatic conversion of the instrument into ordinary shares of the institution if the trigger event or additional trigger event occurs; and

(viii) the institution submits the following information and documents to the Monetary Authority and obtain the prior consent of the Monetary Authority before including any issuance of a capital instrument as Tier 2 capital—

(A) if the terms and conditions of the instrument provide for trigger events in addition to the trigger events specified under this paragraph, a notice in writing to the Monetary Authority containing —

(I) the rationale for those additional trigger events; and

(II) an assessment by the institution of the possible market implications that might arise from the inclusion of those additional trigger events or on the occurrence of those additional trigger events; and

(B) a detailed description of the rationale for the specified conversion method, including computations of the indicative dilution of the institution's ordinary shares that would occur on the occurrence of the trigger event and the resulting ordinary shareholder structure, and an explanation of why such a

conversion approach would help to ensure or maintain the viability of the institution.

Schedule 4D [ss. 38, 39 & 40 & Sch. 4H]

Requirements to be Met for Minority Interests and Capital Instruments Issued by Consolidated Bank Subsidiaries and Held by Third Parties to be Included in Authorized Institution's Capital Base

1. Interpretation of Schedule 4D

In this Schedule—

retained earnings ( ) has the meaning given by section 35 of these Rules.

2. Minority interests and capital instruments

(1) For inclusion of a minority interest in an authorized institution's CET1 capital calculated on a consolidated basis, the following requirements must be met—

(a) the interest must arise from CET1 capital instruments issued by a consolidated bank subsidiary of the institution and held by third parties;

(b) the instruments mentioned in paragraph (a) must, if they were issued by the institution, meet the qualifying criteria set out in Schedule 4A for inclusion in CET1 capital; and

(c) the interest must include retained earnings and reserves and share premium accounts, if any, that are attributable to third parties resulting from the issue of the CET1 capital instruments mentioned in paragraph (a).

(2) For inclusion of a capital instrument in an authorized institution's Additional Tier 1 capital, Tier 1 capital, Tier 2 capital and Total capital calculated on a consolidated basis, the following requirements must be met—

(a) the instrument must be issued by a consolidated bank subsidiary of the institution and held by third parties;

(b) the instrument must, if it were issued by the institution—

(i) meet the qualifying criteria set out in Schedule 4B for inclusion in Additional Tier 1 capital; or

(ii) meet the qualifying criteria set out in Schedule 4C for inclusion in Tier 2 capital; and

(c) the instrument must include share premium accounts, if any, that are attributable to third parties resulting from the issue of the instrument.

(3) For inclusion in an authorized institution's capital base calculated on a consolidated basis, the institution or an affiliate of the institution must not fund directly or indirectly (whether through a special purpose vehicle or through any other vehicle or arrangement) minority investment in the relevant consolidated bank subsidiary of the institution.

(4) For inclusion in an authorized institution's capital base calculated on a consolidated basis, capital instruments issued by subsidiaries of the institution and held by third parties before 1 January 2013 that do not —

(a) meet the qualifying criteria set out in Schedule 4A for inclusion in CET1 capital;

(b) meet the qualifying criteria set out in Schedule 4B for inclusion in Additional Tier 1 capital; or

(c) meet the qualifying criteria set out in Schedule 4C for inclusion in Tier 2 capital,

are subject to the transitional arrangements set out in sections 2 and 4 of Schedule 4H.

3. Computation of applicable amount of minority interests for inclusion in an authorized institution's consolidated CET1 capital

Where a bank subsidiary of an authorized institution is a member of the institution's consolidation group, the maximum amount of minority interests in the subsidiary that may be included in the CET1 capital of the institution on a consolidated basis is the total amount of minority interests arising from the issuance by the subsidiary to third parties of CET1 capital instruments that meet the requirements of section 2, less the amount of surplus CET1 capital of the subsidiary attributable to third parties, where—

(a) the surplus CET1 capital of the subsidiary is calculated as the CET1 capital of the subsidiary less the lower of—

(i) a CET1 capital requirement equivalent to 7% of the sum of the risk-weighted amount for credit risk, risk-weighted amount for market

risk and risk-weighted amount for operational risk of the subsidiary; and

(ii) the portion of the institution's consolidated CET1 capital requirement equivalent to 7% of the sum of the consolidated risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the institution that relates to the subsidiary; and

(b) the amount of the surplus CET1 capital of the subsidiary that is attributable to third parties is calculated by multiplying the surplus CET1 capital by the percentage of the CET1 capital instruments in the subsidiary that are held by third parties.

4. Computation of applicable amount of Tier 1 capital instruments issued by consolidated bank subsidiaries of an authorized institution and held by third parties that are eligible for inclusion in the institution's consolidated Tier 1 capital

(1) Where a bank subsidiary of an authorized institution is a member of the institution's consolidation group, the maximum amount of Tier 1 capital instruments issued by the subsidiary to third parties that may be included in the Tier 1 capital of the institution on a consolidated basis is the total amount of CET1 capital instruments and Additional Tier 1 capital instruments held by third parties that meet the requirements of section 2 less the amount of surplus Tier 1 capital of the subsidiary attributable to third parties, where—

(a) the surplus Tier 1 capital of the subsidiary is calculated as the Tier 1 capital of the subsidiary less the lower of—

(i) a Tier 1 capital requirement equivalent to 8.5% of the sum of the risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the subsidiary; and

(ii) the portion of the institution's consolidated Tier 1 capital requirement equivalent to 8.5 % of the sum of the consolidated risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the institution that relates to the subsidiary; and

(b) the amount of the surplus Tier 1 capital of the subsidiary that is attributable to third parties is calculated by multiplying the surplus Tier 1 capital by the percentage of the sum of the CET1 capital instruments and Additional Tier 1 capital instruments in the subsidiary that are held by third parties.

(2) The amount of Tier 1 capital recognized in the consolidated Additional Tier 1 capital of an authorized institution must exclude the portion that has been recognized in the consolidated CET1 capital under section 3.

5. Computation of applicable amount of Tier 1 capital instruments and Tier 2 capital instruments issued by consolidated bank subsidiaries of authorized institution and held by third parties that are eligible for inclusion in the institution's consolidated Total capital

(1) Where a bank subsidiary of an authorized institution is a member of the institution's consolidation group, the maximum amount of Tier 1 capital instruments and Tier

2 capital instruments issued by the subsidiary to third parties that may be included in the Total capital of the institution on a consolidated basis is the total amount of CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments held by third parties that meet the requirements of section 2 less the amount of surplus Total capital of the subsidiary attributable to third parties, where—

(a) the surplus Total capital of the subsidiary is calculated as the Total capital of the subsidiary less the lower of—

(i) a Total capital requirement equivalent to 10.5% of the sum of the risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the subsidiary; and

(ii) the portion of the institution's consolidated Total capital requirement equivalent to 10.5% of the sum of the consolidated risk-weighted amount for credit risk, risk-weighted amount for market risk and risk-weighted amount for operational risk of the institution that relates to the subsidiary; and

(b) the amount of the surplus Total capital of the subsidiary that is attributable to third parties is calculated by multiplying the surplus Total capital by the percentage of the sum of the CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments in the subsidiary that are held by third parties.

(2) The amount of Total capital recognized in the consolidated Tier 2 capital of an authorized institution

must exclude the portion that has been recognized in the consolidated Tier 1 capital under section 4.

Schedule 4E

[ss. 43, 47 & 48]

Deduction of Holdings of Own CET1 Capital Instruments, Additional Tier 1 Capital Instruments and Tier 2 Capital Instruments

1. Deduction of holdings of own ordinary shares or other CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments

(1) For the purposes of sections 43(1)(l), 47(1)(a) and 48(1)(a) of these Rules, an authorized institution must, subject to subsections (2), (3) and (4)—

(a) calculate the amount of any direct holdings, indirect holdings or synthetic holdings of its own CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments (***own capital instruments***) to be deducted from its capital base on the basis of gross long positions (irrespective of whether the positions are booked in the banking book or the trading book); and

(b) make such deductions from its CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires.

(2) An authorized institution may calculate the amount of holdings of its own capital instruments on the basis of the net long position if the long and short positions are in the same underlying exposure and the short positions involve no counterparty credit risk.

(3) An authorized institution must take the amount to be deducted for indirect holdings that take the form of holdings of index securities as the amount of holdings of index securities that corresponds to the proportion of its own capital instruments included in the underlying index.

(4) An authorized institution may net gross long positions in its own capital instruments resulting from holdings of index securities against short positions in its own capital instruments resulting from short positions in the same underlying index, including where those short positions involve counterparty credit risk.

Schedule 4F

[ss. 43, 47 & 48]

Deduction of Holdings where Authorized Institution does not have Significant Capital Investment in Financial Sector Entities that are outside Scope of Consolidation under Section 3C Requirement

1. Deduction of holdings

(1) For the purposes of sections 43(1)(o), 47(1)(c) and 48(1)(c) of these Rules, an authorized institution must—

(a) calculate the applicable amount of its insignificant capital investments issued by financial sector entities to be deducted from CET1 capital, Additional Tier 1 capital or Tier 2 capital; and

(b) make such deductions from its CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires.

(2) The amount of an authorized institution's insignificant capital investments in CET1 capital instruments issued by financial sector entities to be deducted from the institution's CET1 capital is to be calculated by—

(a) aggregating all of the institution's holdings of insignificant capital investments issued by financial sector entities;

(b) ascertaining the applicable amount of the institution's holdings of insignificant capital investments that in aggregate exceed 10% of the institution's CET1 capital (calculated after applying all regulatory deductions under sections 38(2) and 43(1) of these Rules except those set out in section 43(1)(n), (o), (p) or (q) of these Rules);

(c) ascertaining the institution's holdings of CET1 capital investments as a percentage of the institution's total holdings of insignificant capital investments; and

(d) multiplying the sum obtained in paragraph (b) by the percentage obtained in paragraph (c).

(3) The amount of an authorized institution's insignificant capital investments issued by financial sector entities to be deducted from the institution's Additional Tier 1 capital must be calculated by—

(a) aggregating all of the institution's holdings of insignificant capital investments issued by financial sector entities;

(b) ascertaining the applicable amount of the institution's holdings of insignificant capital investments that in aggregate exceed 10% of the institution's CET1 capital (calculated after applying all regulatory deductions under sections 38(2) and 43(1) of these Rules except those set out in section 43(1)(n), (o), (p) or (q) of these Rules);

(c) ascertaining the institution's holdings of Additional Tier 1 capital investments as a percentage of the institution's total holdings of insignificant capital investments; and

(d) multiplying the sum obtained in paragraph (b) by the percentage obtained in paragraph (c).

(4) The amount of an authorized institution's insignificant capital investments issued by financial sector entities to be deducted from the institution's Tier 2 capital is to be calculated by—

(a) aggregating all of the institution's holdings of insignificant capital investments issued by financial sector entities;

(b) ascertaining the applicable amount of the institution's holdings of insignificant capital investments that in aggregate exceed 10% of the institution's CET1 capital (calculated after applying all regulatory deductions under sections 38(2) and 43(1) of these Rules except those set out in section 43(1)(n), (o), (p) or (q) of these Rules); and

(c) ascertaining the institution's holdings of Tier 2 capital investments as a percentage of the institution's total holdings of insignificant capital investments; and

(d) multiplying the sum obtained in paragraph (b) by the percentage obtained in paragraph (c).

(5) An authorized institution's aggregate holdings of insignificant capital investments issued by financial sector entities are to be calculated as follows—

(a) direct holdings, indirect holdings and synthetic holdings of capital instruments must be included;

(b) the net long positions in both the banking book and trading book must be included and, in this regard, the gross long position may be offset against a short position in the same underlying exposure if the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year;

(c) underwriting positions held for 5 business days or less may be excluded;

(d) if the capital instrument of the entity in which the institution has invested does not meet the qualifying criteria for CET1 capital, Additional Tier 1 capital or Tier 2 capital, the institution must treat the capital instrument as CET1 capital instruments for the purposes of this deduction; and

(e) the institution may, with the prior approval of the Monetary Authority, temporarily exclude certain investments where they have been made in the context of resolving or providing financial assistance to reorganize a distressed authorized institution.

(6) An authorized institution must risk-weight underwriting positions mentioned in subsection (5)(c) in accordance with the applicable risk-weight under Part 4, 5 or 6 of these Rules, as the case requires.

(7) For the purposes of subsections (2), (3) and (4)—

(a) the amount of insignificant capital investments issued by financial sector entities that do not exceed the 10% threshold mentioned in those subsections and that are not deducted from an authorized institution's CET1 capital, Additional Tier 1 capital or Tier 2 capital is to continue to be risk-weighted in accordance with the applicable risk-weight under Part 4, 5 or 6 of these Rules, as the case requires; and

(b) for the application of risk-weighting, the amount of the investments must be allocated on a pro rata basis between those below and those above that threshold.

Schedule 4G

[ss. 43, 47 & 48]

Deduction of Holdings where Authorized Institution has Significant Capital Investment in Financial Sector Entities that are outside Scope of Consolidation under Section 3C Requirement

1. Deduction of holdings

(1) For the purposes of section 43(1)(p) of these Rules, an authorized institution must—

(a) calculate the applicable amount of its significant capital investments issued by financial sector entities to be deducted from CET1 capital; and

(b) make such deductions from its CET1 capital.

(2) The amount of an authorized institution's significant capital investments in CET1 capital instruments issued by financial sector entities to be deducted from the institution's CET1 capital is the amount by which such CET1 capital investments in aggregate exceed 10% of the institution's CET1 capital (calculated after applying all regulatory deductions under sections 38(2) and 43(1) of these Rules except those set out in section 43(1)(p) of these Rules).

(3) The amount of an authorized institution's significant capital investments in Additional Tier 1 capital instruments and Tier 2 capital instruments issued by financial sector entities must be deducted from the institution's Additional Tier 1 capital or Tier 2 capital, as the case requires.

(4) All significant capital investments issued by financial sector entities that are not in the form of CET1 capital instruments must be fully deducted from the same tier of capital for which the capital instruments would qualify if they were issued by the institution itself.

(5) An authorized institution's aggregate holdings of significant capital investments issued by financial sector entities are to be calculated as follows—

(a) direct holdings, indirect holdings and synthetic holdings of capital instruments must be included;

(b) the net long positions in both the banking book and trading book must be included and, in this regard, the gross long position may be offset against a short position in the same underlying exposure if the maturity of the short position either matches the maturity of the long position or has a residual maturity of at least one year;

(c) underwriting positions held for 5 business days or less may be excluded;

(d) if the capital instrument of the entity in which the institution has invested does not meet the qualifying criteria for CET1 capital, Additional Tier 1 capital or Tier 2 capital, the institution must treat the capital instrument as CET1 capital instruments for the purposes of this deduction; and

(e) the institution may, with the prior approval of the Monetary Authority, temporarily exclude certain investments where they have been made in the context of resolving or providing financial assistance to reorganize a distressed authorized institution.

(6) For the purposes of subsection (5)(c), an authorized institution must risk-weight underwriting positions mentioned in that subsection in accordance with the applicable risk-weight under Part 4, 5 or 6 of these Rules, as the case requires.

(7) The amount of CET1 capital investments that do not exceed the 10% threshold mentioned in subsection (2) and that are not deducted from an authorized institution's CET1 capital must be risk-weighted at 250%.

Schedule 4H

[ss. 39, 40, 43, 47 & 48 & Sch. 4D]

Transitional Arrangements in Relation to Banking (Capital) (Amendment) Rules 2012

1. Interpretation of Schedule 4H

In this Schedule—

core capital ( ), in relation to an authorized institution, means the sum, calculated in Hong Kong dollars, of the net book values of the institution's capital items specified in section 38 of the pre-amended Capital Rules;

pre-amended Capital Rules ( ) means the Banking (Capital) Rules (Cap. 155 sub. leg. L) as in force immediately before 1 January 2013;

supplementary capital ( ), in relation to an authorized institution, means the sum, calculated in Hong Kong dollars, of the net book values of the institution's capital items specified in section 42 of the pre-amended Capital Rules.

2. Authorized institution may choose not to apply transitional arrangements

(1) An authorized institution may, for any reason, choose not to apply the transitional arrangements set out in this Schedule for a certain item or individual investment that is subject to deduction from CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires, in accordance with Division 4 of Part 3 of these Rules.

(2) If an authorized institution decides not to apply the transitional arrangements set out in this Schedule for an item or investment under subsection (1), it must inform the Monetary Authority in writing of its decision, and

must not change its decision without the prior approval of the Monetary Authority.

3. Capital deductions

(1) For those items that must be deducted from the capital base of an authorized institution in accordance with Division 4 of Part 3 of these Rules, the deductions must be made in accordance with the applicable arrangements mentioned in this subsection.

(2) The deduction amount of a certain item or investment for which the transitional arrangements set out in this Schedule apply is the amount of that item or investment that was outstanding immediately before 1 January 2013 (adjusted for any fair values changes as required by applicable accounting standards on each reporting date), and any amount in respect of the same item incurred on or after that date must be deducted in accordance with Division 4 of Part 3 of these Rules.

(3) Table A applies, for the purposes of deduction on and after 1 January 2013, in respect of items that were subject to deduction from core capital under section 48(1) of the pre-amended Capital Rules before that date but are subject to deduction from CET1 capital on and after that date.

Table A

Deductions on and after 1 January 2013

Date	Amount to be deducted from core capital before 1 January 2013 expressed in percentage points	Amount to be deducted from CET1 capital on and after 1 January 2013 expressed in percentage points
Before 1 January 2013	100%	0%
On and after 1 January 2013	0%	100%

(4) Table B applies, for the purposes of deduction from 1 January 2013 to 31 December 2017 (both dates inclusive), in respect of items that—

(a) were not deducted under section 48(2)(c), (d), (e) (f) and (g) of the pre-amended Capital Rules, and were subject to the risk-weighting framework of those Rules, before 1 January 2013; and

(b) but for this subsection, would be subject to deduction under Division 4 of Part 3 of these Rules on and after 1 January 2013.

Table B

Deductions from 1 January 2013 to 31 December 2017 (both dates inclusive)

Date from which deduction is to be made	Amount to be deducted expressed in percentage points	Amount to be subject to risk-weighting treatment before 1 January 2013 expressed in percentage points
1 January 2013	0%	100%
1 January 2014	20%	80%
1 January 2015	40%	60%
1 January 2016	60%	40%
1 January 2017	80%	20%

(5) Table C applies, for the purposes of deduction from 1 January 2013 to 31 December 2017 (both dates inclusive), in respect of items that were subject to deduction on an equal basis from core capital and supplementary capital under section 48(2) of the pre-amended Capital Rules before 1 January 2013 but are subject to deduction from CET1 capital on and after 1 January 2013.

Table C

Deductions from 1 January 2013 to 31 December 2017 (both dates inclusive)

Date from which deduction is to be made	Amount to be deducted from CET1 capital expressed in percentage points	Amount to be deducted from Tier 1 capital* expressed in percentage points	Amount to be deducted from Tier 2 capital expressed in percentage points
1 January 2013	0%	50%	50%
1 January 2014	20%	60%	40%
1 January 2015	40%	70%	30%
1 January 2016	60%	80%	20%
1 January 2017	80%	90%	10%

*The amount required to be deducted as specified under this column includes the amount required to be deducted from CET1 capital.

(6) For the purpose of a deduction that an authorized institution is required to make from Tier 1 capital and Tier 2 capital by virtue of the application of Table C—

(a) if the amount required to be deducted from Tier 1 capital is greater than the actual amount of Additional Tier 1 capital, the amount of excess must be deducted from the institution's CET1 capital;

(b) if the amount required to be deducted from Tier 2 capital is greater than the actual amount of Tier 2 capital, the amount of shortfall must be met by the institution's Tier 1 capital.

4. Recognition of minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties in authorized institution's capital base

(1) If a minority interest or any capital instrument issued by a bank subsidiary of an authorized institution and held by third parties is eligible for inclusion in the capital base of the institution in accordance with Part 3 of these Rules, it may be so included on and after 1 January 2013.

(2) If a minority interest or any capital instrument issued by a subsidiary of an authorized institution that is subject to a section 3C requirement is no longer eligible for inclusion in the institution's capital base on 1 January 2013 but was included in the calculation of the institution's capital base before that date, such minority interest or capital instrument must be progressively excluded from the capital base of the institution in accordance with Table D.

Table D

Exclusion of Non-eligible Minority Interests or Capital Instruments from Capital Base of Authorized Institution

Date from which minority interests or capital instruments are to be excluded	Amount of minority interests or capital instruments to be excluded expressed in percentage points
1 January 2013	0%
1 January 2014	20%

Date from which minority interests or capital instruments are to be excluded	Amount of minority interests or capital instruments to be excluded expressed in percentage points
1 January 2015	40%
1 January 2016	60%
1 January 2017	80%
1 January 2018	100%

5. Capital instruments that no longer qualify for inclusion in capital base

(1) The capital instruments (***extant capital instruments***) of an authorized institution that were included in an authorized institution's capital base immediately before 1 January 2013 but do not meet all the qualifying criteria set out in Schedule 4A, 4B or 4C, as the case may be, must be phased out during the 10-year period beginning from that date.

(2) Subject to subsections (3), (4), (5) and (6), for the purpose of calculating the amount of extant capital instruments to be phased out, the maximum amount of extant capital instruments that may be recognized in the capital base of an authorized institution from 1 January 2013 to 31 December 2021 (both dates inclusive) is limited to the sum of the nominal amount (including any related share premium) of instruments that are recognized in the capital base of the institution immediately before 1 January 2013 and—

(a) that are issued on or before 12 September 2010; or

(b) that are issued on or before 31 December 2012 and—

(i) in the case of Additional Tier 1 capital instruments, meet the qualifying criteria set out in Schedule 4B (excluding section 1(p) of that Schedule); or

(ii) in the case of Tier 2 capital instruments, meet the qualifying criteria set out in Schedule 4C (excluding section 1(j) of that Schedule),

multiplied by a progressively reducing percentage during the period as specified in Table E.

Table E

Progressive Phasing Out of Non-eligible Capital Instruments

Date from which reducing percentage is applicable	Amount to be included in capital base expressed in percentage point
1 January 2013	90%
1 January 2014	80%
1 January 2015	70%
1 January 2016	60%
1 January 2017	50%
1 January 2018	40%
1 January 2019	30%
1 January 2020	20%
1 January 2021	10%

(3) The aggregate amount of supplementary capital instruments of an authorized institution that was excluded from the institution's capital base before 1 January 2013 on the basis that—

(a) the institution's total supplementary capital was greater than the institution's total core capital; or

(b) the part of the institution's total supplementary capital that comprised term debt was greater than 50% of the institution's total core capital,

may, if those capital instruments meet all the qualifying criteria specified in Schedule 4B or 4C, as the case may be, and with the approval of the Monetary Authority, be included in the institution's capital base.

(4) The maximum amount referred to in subsection (2) must be calculated separately for Additional Tier 1 capital instruments and Tier 2 capital instruments.

(5) The nominal amount referred to in subsection (2) must have taken into account the required amortization specified in section 1(d) of Schedule 4C in the case of Tier 2 capital instruments, but any redemption or amortization of instruments occurring on or after 1 January 2013 must not reduce the nominal amount.

(6) Extant capital instruments with an incentive to be redeemed are subject to the following treatments—

(a) for an instrument with a call option in combination with a step-up (or another incentive to redeem) that was exercisable on a date (***specified date***) before 1 January 2013, if the instrument was not called on the specified date and, on a forward-looking basis, will meet the qualifying criteria for inclusion in Additional Tier 1 capital or Tier 2 capital, the

instrument may be recognized as Additional Tier 1 capital or Tier 2 capital, as the case requires;

(b) for an instrument with a call option in combination with a step-up (or another incentive to redeem) that is exercisable on a date (***specified date***) that falls on or after 1 January 2013—

(i) if the instrument is not called on the specified date and, on a forward-looking basis, will meet the qualifying criteria for inclusion in Additional Tier 1 capital or Tier 2 capital, the instrument may be recognized as Additional Tier 1 capital or Tier 2 capital, as the case requires, on and after the specified date; and

(ii) before the specified date, the instrument must be treated as an instrument that no longer qualifies as Additional Tier 1 capital or Tier 2 capital and, accordingly, must be phased out in accordance with Table E;

(c) for an instrument with a call option in combination with a step-up (or another incentive to redeem) that was exercisable on a date (***specified date***) between 12 September 2010 and 31 December 2012 (both dates inclusive), if the instrument was not called on the specified date and, on a forward-looking basis, will not meet the qualifying criteria for inclusion in Additional Tier 1 capital or Tier 2 capital, the instrument will no longer be recognized as regulatory capital and will be excluded from the institution's capital base on and after 1 January 2013;

(d) for an instrument with a call option in combination with a step-up (or another incentive to redeem) that

is exercisable on a date (***specified date***) after 31 December 2012—

(i) if the instrument is not called on the specified date and, on a forward-looking basis, will not meet the qualifying criteria for inclusion in Additional Tier 1 capital or Tier 2 capital, the instrument will no longer be recognized as regulatory capital and will be excluded from the institution's capital base on and after the specified date; and

(ii) before the specified date, the instrument must be treated as an instrument that no longer qualifies as Additional Tier 1 capital or Tier 2 capital and, accordingly, must be phased out in accordance with Table E; and

(e) for an instrument with a call option in combination with a step-up (or another incentive to redeem) that was exercisable on a date (***specified date***) that falls on or before 12 September 2010, if the instrument was not called on the specified date and, on a forward-looking basis, will not meet the qualifying criteria for inclusion in Additional Tier 1 capital or Tier 2 capital, the instrument must be treated as an instrument that no longer qualifies as Additional Tier 1 capital or Tier 2 capital and, accordingly, must be phased out in accordance with Table E.".

157. Schedule 5 repealed (other deductions from core capital and supplementary capital)

Schedule 5—

Repeal the Schedule.

158. Schedule 6 amended (credit quality grades)

(1) Schedule 6, after "[ss. 55, 59, 60, 61, 61A, 62, 79, 98, 99, 139, 211,"—

Add

"232A,"

(2) Schedule 6, Chinese text, Table C, Part 2, column 3—

Repeal

"CRISIL

BBB+

CRISIL BBB

CRISIL BBB-"

Substitute

"CRISIL BBB+

CRISIL BBB

CRISIL BBB-".

159. Schedule 7 amended (standard supervisory haircuts for comprehensive approach to treatment of recognized collateral)

(1) Schedule 7, section 1, Table—

Repeal Part 1

Substitute

"**Part 1**

Standard Supervisory Haircuts for Debt Securities

Standard supervisory haircuts

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Sovereign issuers	Other issuers	Securitization exposures (excluding re-securitization exposures)
1.	Debt securities with ECAI issue specific ratings	grade 1 (in relation to Table A, Table B, Part 1 of Table C or Part 1 of Table E in Schedule 6, or Table A or Table B in Schedule 11) and grades 1 and 2 (in relation to Part 2 of Table C or Part 2 of Table E in Schedule 6)	(a) not more than 1 year	0.5%	1%	2%
			(b) more than 1 year but not more than 5 years	2%	4%	8%
			(c) more than 5 years	4%	8%	16%
2.	Recognized collateral that falls within any	grade 1 (in relation to Table A, Table B,	(a) not more than 1 year	0.5%	1%	2%

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Sovereign issuers	Other issuers	Securitization exposures (excluding re-securitization exposures)
	of section 79(1)(e) to (la) of these Rules	Part 1 of Table C or Part 1 of Table E in Schedule 6, or Table A or Table B in Schedule 11) and grades 1 and 2 (in relation to Part 2 of Table C or Part 2 of Table E in Schedule 6)	(b) more than 1 year but not more than 5 years	2%	4%	8%
			(c) more than 5 years	4%	8%	16%
3.	Debt securities with ECAI issue specific ratings	grades 2 and 3 (in relation to Table A, Table B, Part 1 of Table C or	(a) not more than 1 year	1%	2%	4%
			(b) more than 1	3%	6%	12%

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Sovereign issuers	Standard supervisory haircuts: Other issuers	Standard supervisory haircuts: Securitization exposures (excluding re-securitization exposures)
		Part 1 of Table E in Schedule 6, or Table A or Table B in Schedule 11) and grades 3 and 4 (in relation to Part 2 of Table C or Part 2 of Table E in Schedule 6)	year but not more than 5 years			
			(c) more than 5 years	6%	12%	24%
4.	Recognized collateral that falls within any of section 79(1)(e) to (la) of these Rules	grades 2 and 3 (in relation to Table A, Table B, Part 1 of Table C or Part 1 of Table E in	(a) not more than 1 year	1%	2%	4%
			(b) more than 1 year but not	3%	6%	12%

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Sovereign issuers	Standard supervisory haircuts: Other issuers	Standard supervisory haircuts: Securitization exposures (excluding re-securitization exposures)
		Schedule 6, or Table A or Table B in Schedule 11) and grades 3 and 4 (in relation to Part 2 of Table C or Part 2 of Table E in Schedule 6)	more than 5 years			
			(c) more than 5 years	6%	12%	24%
5.	Debt securities with long-term ECAI issue specific ratings	grade 4	All	15%	not applicable	not applicable

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Sovereign issuers	Standard supervisory haircuts: Other issuers	Standard supervisory haircuts: Securitization exposures (excluding re-securitization exposures)
6.	Recognized collateral that falls within section 79(1)(e), (f) or (h) of these Rules	grade 4	All	15%	not applicable	not applicable
7.	Debt securities without ECAI issue specific ratings issued by banks or securities firms, that satisfy the criteria set out in section 79(1)(m) of these Rules	not applicable	(a) not more than 1 year	not applicable	2%	not applicable
			(b) more than 1 year but not more than 5 years	not applicable	6%	not applicable
			(c) more than 5 years	not applicable	12%	not applicable

Item	Types of exposure or recognized collateral	Credit quality grade/short-term credit quality grade	Residual maturity	Standard supervisory haircuts: Sovereign issuers	Standard supervisory haircuts: Other issuers	Standard supervisory haircuts: Securitization exposures (excluding re-securitization exposures)
8.	Recognized collateral that falls within section 79(1)(m) of these Rules	not applicable	(a) not more than 1 year	not applicable	2%	not applicable
			(b) more than 1 year but not more than 5 years	not applicable	6%	not applicable
			(c) more than 5 years	not applicable	12%	not applicable".

(2) Schedule 7, Part 2, item 2—

Repeal

"79(a)"

Substitute

"79(1)(a)".

(3) Schedule 7, Part 2, item 4—

Repeal

"79(d)"

Substitute

"79(1)(d)".

(4) Schedule 7, Part 2, item 6—

Repeal

"80(b)"

Substitute

"80(1)(b)".

(5) Schedule 7, Part 2, item 8—

Repeal

"79(o) or 80(c)"

Substitute

"79(1)(o) or 80(1)(c)".

(6) Schedule 7, Part 3, item 4—

Repeal

"80(a)"

Substitute

"80(1)(a)".

Monetary Authority

2012

Explanatory Note

These Rules are made by the Monetary Authority under section 97C of the Banking Ordinance (Cap. 155) as amended by the Banking (Amendment) Ordinance 2012 (3 of 2012), and amend the Banking (Capital) Rules (Cap. 155 sub. leg. L) (***principal Rules***).

2. The principal Rules, which were made in 2006, prescribe the manner in which the capital adequacy ratio of an authorized institution incorporated in Hong Kong is to be calculated. The principal Rules have now been in operation for over 5 years and were last amended by the Banking (Capital) (Amendment) Rules 2011 (L.N. 137 of 2011).

3. The main purpose of the Rules is to incorporate into the principal Rules—

(a) amendments relating to the internal model method for calculating counterparty credit risk as set out in Annex 4 to the document entitled "International Convergence of Capital Measurement and Capital Standards: A Revised Framework—Comprehensive Version" (***Basel II***) issued by the Basel Committee on Banking Supervision (***Basel Committee***) in June 2006;

(b) amendments relating to enhancements to the risk coverage of Basel II set out in the document entitled "Basel III: A global regulatory framework for more resilient banks and banking systems" issued by the Basel Committee in December 2010;

(c) amendments relating to the new capital framework for exposures to central counterparties set out in the document entitled "Capital requirements for bank exposures to central counterparties" issued by the Basel Committee in July 2012;

(d) amendments relating to the revised treatment of debt valuation adjustments in respect of derivative liabilities arising from changes in the market value of an authorized institution's own credit risk, as set out in the press release entitled "Regulatory treatment of valuation adjustments to derivative liabilities: final rule issued by the Basel Committee" issued by the Basel Committee in July 2012;

(e) amendments relating to bringing the capital treatment of trade finance in line with that set out in the document entitled "Treatment of trade finance under the Basel capital framework" issued by the Basel Committee in October 2011;

(f) amendments relating to the capital and capital ratios of an authorized institution as set out in the document mentioned in paragraph (b) and the supplementary document entitled "Minimum requirements to ensure loss absorbency at the point of non-viability" issued by the Basel Committee in January 2011;

(g) amendments necessitated by problems and ambiguities identified by the Monetary Authority in the operation of the principal Rules to date; and

(h) technical amendments for achieving internal consistency in terminology and consistency between the Chinese and English texts of the principal Rules.

4. The Rules come into operation on 1 January 2013.