Annex

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Banking (Capital) (Amendment) Rules 2013

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Contents

Banking (Capital) (Amendment) Rules 2013

(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 30 June 2013.

2. Banking (Capital) Rules amended

The Banking (Capital) Rules (Cap. 155 sub. leg. L) are amended as set out in sections 3 to 29.

3. Section 2 amended (interpretation)

Section 2(1)—

Add in alphabetical order

"***qualifying CCP*** (合資格 CCP) has the meaning given by section 226V(1);".

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

(1) Section 100—

Repeal subsection (1)

Substitute

"(1) Where an authorized institution's exposure is covered by a recognized guarantee or recognized credit derivative contract, the institution must determine the risk-weight to be allocated to the exposure in accordance with subsections (2), (3), (4), (5), (6), (7), (8), (9) and (10).".

(2) Section 100(2)—

Repeal

"(8) and (9),"

Substitute

"(8), (9) and (10),".

(3) Section 100(2)(a)—

Repeal

"the credit protection covered portion of".

(4) After section 100(9)—

Add

"(10) Where an authorized institution's exposure is covered by a recognized credit derivative contract cleared by a qualifying CCP, the institution may allocate to the credit protection covered portion of the exposure—

(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP; or

(ii) the institution is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) a risk-weight of 4% if the institution is a client of a clearing member of the 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.".

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

(1) Section 101(3)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(2) Section 101(4)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(3) Section 101(6)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(4) After section 101(6)—

Add

"(6A) For the purposes of subsections (3), (4) and (6), where the credit derivative contract concerned is cleared by a qualifying CCP, the words "the attributed risk-weight of the credit protection provider" in those subsections are deemed to read as—

(a) "a risk-weight of 2%" if—

(i) the authorized institution concerned is a clearing member of the qualifying CCP; or

(ii) the authorized institution concerned is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) "a risk-weight of 4%" if the authorized institution concerned is a client of a clearing member of the 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.".

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

(1) Section 134—

Repeal subsection (1)

Substitute

"(1) Where an authorized institution's exposure is covered by a recognized guarantee or recognized credit derivative contract, the institution must determine the risk-weight to be allocated to the exposure in accordance with subsections (2), (3), (4), (5), (6) and (7).".

(2) Section 134(2)—

Repeal

"(4) and (5),"

Substitute

"(4), (5), (6) and (7),".

(3) Section 134(2)(a)—

Repeal

"the credit protection covered portion of".

(4) Section 134(3)—

Repeal

"a guarantor"

Substitute

"the guarantor of the recognized guarantee".

(5) After section 134(6)—

Add

"(7) Where an authorized institution's exposure is covered by a recognized credit derivative contract cleared by a qualifying CCP, the institution may allocate to the credit protection covered portion of the exposure—

(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP; or

(ii) the institution is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) a risk-weight of 4% if the institution is a client of a clearing member of the 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. Section 135 amended (provisions supplementary to section 134)

(1) Section 135(3)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(2) Section 135(4)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(3) Section 135(6)—

Repeal

"Where"

Substitute

"Subject to subsection (6A), where".

(4) After section 135(6)—

Add

"(6A) For the purposes of subsections (3), (4) and (6), where the credit derivative contract concerned is cleared by a qualifying CCP, the words "the attributed risk-weight of the credit protection provider" in those subsections are deemed to read as—

(a) "a risk-weight of 2%" if—

(i) the authorized institution concerned is a clearing member of the qualifying CCP; or

(ii) the authorized institution concerned is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) "a risk-weight of 4%" if the authorized institution concerned is a client of a clearing member of the 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.".

8. Section 168 amended (maturity under advanced IRB approach)

Section 168(1), Formula 20A, paragraph (c)—

Repeal

"maturity ="

Substitute

"*maturity* =".

9. Section 203 amended (credit risk mitigation—general)

Section 203(1A)—

Repeal

"estimates of any of the credit risk components of the applicable risk-weight function"

Substitute

"calculation of the risk-weighted amount for its exposures".

10. Section 215 amended (provisions supplementary to section 214(1)—substitution framework (general))

Section 215(b), after "shall,"—

Add

"subject to sections 216(3B) and 217(5),".

11. 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 "(3A),"—

Add

"(3B),".

(2) Section 216(2)(a)—

Repeal

"(3) and (3A)".

Substitute

"(3), (3A) and (3B)".

(3) Section 216(3)—

Repeal

"An"

Substitute

"Subject to subsection (3B), an".

(4) After section 216(3A)—

Add

"(3B) Where an authorized institution's exposure is covered by a recognized credit derivative contract cleared by a qualifying CCP, the institution may allocate to the covered portion of the exposure—

(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP; or

(ii) the institution is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) a risk-weight of 4% if the institution is a client of a clearing member of the 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.".

12. 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(1)—

Repeal

"subsection (2) and sections 210(2) and 215,"

Substitute

"subsections (2) and (5),".

(2) After section 217(4)—

Add

"(5) Where an authorized institution's exposure is covered by a recognized credit derivative contract cleared by a qualifying CCP, the institution may allocate to the covered portion of the exposure—

(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP; or

(ii) the institution is a client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(b) a risk-weight of 4% if the institution is a client of a clearing member of the 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.".

13. Section 226D amended (calculation of IMM(CCR) risk-weighted amount at portfolio level under IMM(CCR) approach)

Section 226D(1)(b), Chinese text—

Repeal

"包括"

Substitute

"包含".

14. Section 226P amended (advanced CVA method)

(1) Section 226P(2)(a)—

Repeal

"and".

(2) Section 226P(2)(b)—

Repeal

"referenced)."

Substitute

"referenced); and".

(3) After section 226P(2)(b)—

Add

"(c) it properly captures the non-linear risk of options on credit default swaps if the institution, under subsection (3), includes eligible CVA hedges that consist of such options in the CVA capital charge calculation for the purpose of reducing the institution's CVA capital charge."

15. Section 226S amended (standardized CVA method)

(1) Section 226S(1), Formula 23J, paragraph (d)—

Repeal

"credit default swap, with counterparty "*i*" as the reference entity,"

Substitute

"eligible CVA hedge referencing counterparty "*i*"".

(2) Section 226S(1), Formula 23J, paragraph (e)—

Repeal

"index credit default swap on"

Substitute

"eligible CVA hedge referencing".

(3) Section 226S(1), Formula 23J, paragraph (e)(ii)—

Repeal

"index credit default swap"

Substitute

"index eligible CVA hedge".

(4) Section 226S(1), Formula 23J, paragraph (e)(ii)—

Repeal

"the swap"

Substitute

"the hedge".

(5) Section 226S(1), Formula 23J, paragraph (e)(ii)—

Repeal

"credit default swap on"

Substitute

"eligible CVA hedge for".

(6) Section 226S(1), Formula 23J, paragraph (f)—

Repeal

"index credit default swap"

Substitute

"index eligible CVA hedge".

(7) Section 226S(1), Formula 23J, paragraph (h)—

Repeal

"credit default swap"

Substitute

"single-name eligible CVA hedge".

(8) Section 226S(1), Formula 23J, paragraph (i)—

Repeal

"credit default swap"

Substitute

"index eligible CVA hedge".

(9) After section 226S(2)—

Add

"(2A) For the purposes of paragraph (c) in Formula 23J, if an authorized institution uses—

(a) the IRB approach to calculate the institution's credit risk for non-securitization exposures to the counterparty; and

(b) the current exposure method to calculate the institution's default risk exposures in respect of derivative contracts, or the methods referred to in section 10A(1)(b) to calculate such exposures in respect of SFTs,

the institution may recognise the credit risk mitigating effect of recognized collateral by applying Formula 19 and in accordance with section 160(3), and take the resulting net credit exposure (E*) as the basis for determining the EAD_i^{total} of a netting set in accordance with other applicable provisions of this section.".

(10) Section 226S(4)—

Repeal

"credit default swap"

Substitute

"eligible CVA hedge".

(11) Section 226S(4)—

Repeal

"swaps"

Substitute

"hedges".

(12) Section 226S(5)—

Repeal

"credit default swap"

Substitute

"eligible CVA hedge".

(13) Section 226S(5)—

Repeal

"swaps"

Substitute

"hedges".

(14) After section 226S(5)—

Add

"(5A) If the hedging instrument used in an eligible CVA hedge is an option on a credit default swap (regardless of whether the swap is a single-name or index credit default swap), an authorized institution may construe the notional amount mentioned in paragraph (d) or (e) in Formula 23J, as the case requires, as the delta-adjusted notional amount of the option concerned."

16. Section 226T amended (eligible CVA hedge)

(1) After section 226T(1)(b)—

Add

"(ba) the external counterparties of the hedges fall within section 99(1)(b)(i), (ii), (iii), (iv), (v) or (vi);".

(2) Section 226T(1)(c)(iii)—

Repeal

"directly; or"

Substitute

"directly;".

(3) Section 226T(1)(c)(iv), after "swaps;"

Add

"or".

(4) After section 226T(1)(c)(iv)—

Add

"(v) subject to subsection (2), options on index credit default swaps where the options do not contain a clause that would result in the options being terminated following a credit event;".

(5) Section 226T(6)(b)—

Repeal

"and".

(6) After section 226T(6)(b)—

Add

"(ba) must not, if it has over-hedged the CVA risk in respect of a counterparty with an eligible CVA hedge that falls within subsection (1)(c)(i), (ii) or (iii), include the excess portion of the eligible CVA hedge in its CVA capital charge calculation for the purpose of reducing its CVA capital charge; and".

(7) After section 226T(6)—

Add

"(7) An authorized institution that has over-hedged the CVA risk in respect of a counterparty with an eligible CVA hedge (***CVA hedge A***) may, with the prior consent of the Monetary Authority, treat any credit protection sold for the purpose of unwinding the excess portion of CVA hedge A as an eligible CVA hedge for the CVA risk associated with the excess portion of CVA hedge A if—

(a) all the applicable requirements set out in subsection (1) are met in respect of the protection sold; and

(b) the protection sold is subject to the same process, documentation and controls applicable to eligible CVA hedges.".

17. Section 226X amended (exposures of clearing members to qualifying CCPs)

(1) After section 226X(2)—

Add

"(2A) For the purposes of subsections (1) and (2), if an authorized institution uses the IRB approach to calculate its credit risk for non-securitization exposures, the institution must take into account any credit risk mitigating effect in its calculation of the risk-weighted amount of default risk exposures to qualifying CCPs in accordance with Division 10 of Part 6 with the following modifications—

(a) the institution may recognise the credit risk mitigating effect of recognized collateral by applying Formula 19 and in accordance with section 160(3), and take the resulting net credit exposure (E*) as the basis for determining the risk-weighted amount;

(b) the institution may recognise the credit risk mitigating effect of a recognized guarantee by applying Part 4 unless—

(i) an exposure of the institution to the qualifying CCP is fully covered by a recognized guarantee; and

(ii) the institution uses the IRB approach to calculate its credit risk for exposures to the guarantor of the recognized guarantee mentioned in subparagraph (i);

(c) the institution may recognise the credit risk mitigating effect of a recognized credit derivative contract by applying Part 4 unless—

(i) an exposure of the institution to the qualifying CCP is fully covered by a recognized credit derivative contract; and

(ii) the institution uses the IRB approach to calculate its credit risk for exposures to the counterparty to the recognized credit derivative contract mentioned in subparagraph (i).".

(2) Section 226X(3)—

Repeal

"subsection (2)"

Substitute

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

(3) Section 226X(6)—

Repeal paragraph (a)

Substitute

"(a) TE_i = the total of the default risk exposures of the institution referred to in subsection (1) to the qualifying CCP, excluding any collateral that—

(i) is initial margin posted by the institution or variation margin payable by the CCP to the institution;

(ii) is held by a custodian (within the meaning of 226ZE(8)); and

(iii) is bankruptcy remote from the CCP; and".

18. Section 226Z amended (exposures of clearing members to clients)

After section 226Z(2)—

Add

"(2A) For the purposes of subsections (1) and (2), if—

(a) an authorized institution has collected collateral from its client for a transaction cleared by a CCP and passed on the collateral to the CCP to secure that transaction; and

(b) the collateral is not recognized collateral in respect of the institution's default risk exposure to the client arising from the transaction because the institution does not have a first-lien (or any similar right or security interest) on the collateral,

the institution may take into account the credit risk mitigating effect of the collateral passed on to the CCP in calculating the risk-weighted amount of the institution's default risk exposure to the client arising from the transaction as if the collateral were recognized collateral.".

19. Section 226ZD amended (exposures of clearing members to non-qualifying CCPs)

After section 226ZD(1)—

Add

"(1A) To avoid doubt, for the purposes of subsection (1), an authorized institution must take into account any credit risk mitigating effect in its calculation of the risk-weighted amount of its exposures to non-qualifying CCPs in accordance with Part 4.".

20. Section 265 amended (recognized credit risk mitigation)

Section 265(b)(ii)—

Repeal

"216(3)"

Substitute

"216(3), section 216(3) and (3A) or section 216(3B), as the case may be,".

21. Section 278 amended (treatment of recognized credit risk mitigation—full credit protection)

Section 278(b)(ii)—

Repeal

"216(3);"

Substitute

"216(3), section 216(3) and (3A) or section 216(3B), as the case may be;".

22. Section 308 amended (use of credit derivative contracts to offset specific risk)

(1) Section 308(1)—

Repeal

"which is identical to the reference obligation specified in the credit derivative contract, or in another credit derivative contract,".

(2) After section 308(1)—

Add

"(1A) Subject to subsection (2), an authorized institution may use a credit derivative contract booked in the institution's trading book to offset the market risk capital charge for specific risk calculated for the institution's trading book position in another credit derivative contract in accordance with—

(a) section 309 (excluding section 309(1)(b)) with all necessary modifications;

(b) section 310 with all necessary modifications; or

(c) section 311 (excluding section 311(1)(a)) with all necessary modifications.".

(3) Section 308(2)—

Repeal

"which is identical to the reference obligation specified in the credit derivative contract,".

23. Section 309 amended (offsetting in full)

(1) Section 309(1)—

Repeal

"fully offset its position in a credit derivative contract against a position in the underlying exposure which is identical to the reference obligation specified in the credit derivative contract, or against a position in another credit derivative contract, where the values of the 2 positions, being the long or short

position in the credit derivative contract, and the short or long position respectively in the underlying exposure which is identical to the reference obligation specified in the credit derivative contract or the short or long position respectively in the other credit derivative contract,"

Substitute

"offset 100% of the market risk capital charge for specific risk for its position in a credit derivative contract against that for a position in the underlying exposure which is identical to the reference obligation specified in the contract where the values of the 2 positions, being the long or short position in the contract, and the short or long position respectively in the underlying exposure which is identical to the reference obligation specified in the contract,".

(2) Section 309(2)—

Repeal

"has fully offset its position in a credit derivative contract against a position in the underlying exposure which is identical to the reference obligation specified in the credit derivative contract, or against a position in another credit derivative contract,"

Substitute

"offsets the market risk capital charge for specific risk for its positions".

24. Section 310 amended (offsetting by 80%)

(1) Section 310(1), after "against"—

Add

"that for".

(2) Section 310(2)(b)(ii)—

Repeal

"position in the underlying exposure;"

Substitute

"swap contract or note, as the case may be;".

(3) Section 310(2)(b)(iii)—

Repeal

"the reference obligation specified in".

(4) Section 310(3)—

Repeal

"its positions in a credit derivative contract"

Substitute

"the market risk capital charge for specific risk for its positions".

25. Section 311 amended (other offsetting)

(1) Section 311(1)—

Repeal

"a position in the underlying exposure which is identical to the reference obligation specified in the contract where the values of the 2 positions, being the long or short position in the contract, and the short or long position respectively in the underlying exposure which is identical to the reference obligation specified in the contract,"

Substitute

"that for a position in the underlying exposure where the values of the 2 positions, being the long or short position in the contract, and the short or long position respectively in the underlying exposure,".

(2) Section 311(1)(a), English text—

Repeal

"position would"

Substitute

"positions would".

(3) Section 311(1)(a), after "between the reference obligation"—

Add

"specified in the contract".

(4) Section 311(1)(b), English text—

Repeal

"position would"

Substitute

"positions would".

(5) Section 311(1)(c)—

Repeal

"position would fall within section 310 but for there being a mismatch between the position in the underlying exposure and the reference obligation specified in the contract"

Substitute

"positions would fall within section 310 but for there being an asset mismatch between the reference obligation specified in the contract and the position in the underlying exposure".

(6) Section 311—

Repeal subsection (2)

Substitute

"(2) Where an authorized institution offsets the market risk capital charge for specific risk for its positions pursuant to subsection (1)—

(a) 100% of the market risk capital charge for specific risk is required to be calculated for the position with the higher market risk capital charge for specific risk; and

(b) the market risk capital charge for specific risk to be calculated for the other position is to be zero.".

26. Schedule 1A amended (transactions and contracts not subject to CVA capital charge)

(1) Schedule 1A, section 1—

Repeal paragraph (e)

Substitute—

"(e) OTC derivative transactions, credit derivative contracts and SFTs (other than those falling within paragraph (a), (b), (c) or (d))—

(i) that are in default as determined under the terms and conditions of the transactions or contracts;

(ii) in respect of which the losses due to the default have been recognized by the authorized institution concerned for accounting and reporting purposes; and

(iii) in respect of which the exposures have been transformed into simple claims that do not have the risk characteristics of derivative contracts or SFTs.".

(2) Schedule 1A, section 2—

Repeal

"a qualifying CCP (within the meaning of section 226V(1) of these Rules)"

Substitute

"a qualifying CCP".

27. Schedule 4F amended (deduction of holdings where authorized institution has insignificant capital investments in financial sector entities that are outside scope of consolidation under section 3C requirement)

(1) Schedule 4F, section 1(6)—

Repeal

"5 or 6"

Substitute

"5, 6 or 8".

(2) Schedule 4F, section 1(8)(a)—

Repeal

"5 or 6"

Substitute

"5, 6 or 8".

28. Schedule 4G amended (deduction of holdings where authorized institution has significant capital investments in financial sector entities that are outside scope of consolidation under section 3C requirement)

Schedule 4G, section 1(5)—

Repeal

"5 or 6"

Substitute

"5, 6 or 8".

29. Schedule 4H amended (transitional arrangements in relation to Banking (Capital) (Amendment) Rules 2012)

(1) Schedule 4H, section 3(5)—

Repeal

"deduction from CET1 capital"

Substitute

"deduction from CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires,".

(2) Schedule 4H, section 3(5)—

Repeal Table C

Substitute

"**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, Additional Tier 1 capital or Tier 2 capital, as the case requires, expressed in percentage points	Remaining amount to be deducted on an equal basis from Tier 1 capital and Tier 2 capital expressed in percentage points
1 January 2013	0%	100%
1 January 2014	20%	80%
1 January 2015	40%	60%

Date from which deduction is to be made	Amount to be deducted from CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires, expressed in percentage points	Remaining amount to be deducted on an equal basis from Tier 1 capital and Tier 2 capital expressed in percentage points
1 January 2016	60%	40%
1 January 2017	80%	20%".

(2) Schedule 4H, section 5(2)(b)(i)—

Repeal

"1(p)"

Substitute

"1(q)".

(3) Schedule 4H, section 5(2)(b)(ii)—

Repeal

"1(j)"

Substitute

"1(k)".

Monetary Authority

2013

Explanatory Note

These Rules are made by the Monetary Authority under section 97C of the Banking Ordinance (Cap. 155) and amend the Banking (Capital) Rules (Cap. 155 sub. leg. L) (***principal Rules***).

2. The main purpose of the Rules is to incorporate into the principal Rules—

(a) amendments relating to the clarifications in respect of the capital treatments for counterparty credit risk as set out in the document entitled "Basel III counterparty credit risk and exposures to central counterparties — Frequently asked questions" published by the Basel Committee on Banking Supervision (***Basel Committee***) in December 2012;

(b) amendments for clarifying—

(i) the treatment of certain capital investments booked in an authorized institution's trading book that are not required to be deducted from the institution's capital base;

(ii) the transitional arrangements for the treatment of certain capital deductions and capital instruments; and

(iii) how, if the usual prescribed treatment under the internal ratings-based approach for credit risk cannot be applied, an authorized institution that adopts that approach in the calculation of its regulatory capital ratios should recognize the effect of credit risk mitigation under—

(A) the standardized CVA method; and

(B) the framework for calculating regulatory capital for exposures to central counterparties;

(c) amendments for bringing certain provisions of the principal Rules into alignment with corresponding provisions of 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

(d) technical amendments for achieving internal consistency in the provisions of the principal Rules.

3. The Rules come into operation on 30 June 2013.