

Completion Instructions

Return of Capital Adequacy Ratio Part II – Capital Base Form MA(BS)3(II)

Introduction

1. Form MA(BS)3(II) should be completed by an authorized institution incorporated in Hong Kong to determine its capital base for the calculation of capital adequacy ratio (CAR).
2. This Form and its completion instructions should be read in conjunction with the Banking (Capital) Rules and the following Supervisory Policy Manual (SPM):
 - a. CA-S-6 “Instruments Eligible for Inclusion in Core Capital”
 - b. CA-S-7 “Term Subordinated Debt and Paid-up Term Preference Shares for Inclusion in Supplementary Capital”
 - c. CA-S-8 “Perpetual Subordinated Debt and Paid-up Irredeemable Cumulative Preference Shares for Inclusion in Supplementary Capital”
 - d. ~~[CA-S-9X] “Use of the Fair Value Option for Financial Instruments~~ Fair Value Practices¹
3. The institution shall refer to sections 2 and 35 of the Rules for the interpretation of the terms used in this form and its completion instructions.

Specific Instructions

Item

Nature of item

Part II(a)

Capital Base

4. For the purpose of calculating the institution’s CAR, the capital base of the institution shall be the sum of the institution’s total *core capital* (Tier 1) and total *supplementary capital* (Tier 2), after: (i) making all deductions; and (ii) applying the various limits, to the relevant tiers and components of such capital in the manner required by the Rules. The value of the components of core capital and supplementary capital shall be determined by taking their net book values, calculated in Hong Kong dollars.
5. The institution shall not include in its core capital or supplementary capital any capital instruments issued at a discount, or only partly in a paid-up form, except to the

¹ The SPM module is being finalized for issuance within the third quarter of 2011.

extent that the proceeds paid-up on such instruments have been received by and are immediately available to the issuer of the instrument.

<u>Item</u>	<u>Nature of item</u>
Category I	Core Capital
(a)	<u>Paid-up ordinary share capital</u> 6. Report the institution's paid-up ordinary share capital other than any shares issued by the institution through capitalizing any property revaluation reserves of the institution referred to in item (h) of Category II below.
(b)	<u>Paid-up irredeemable non-cumulative preference shares</u> 7. Report the institution's paid-up <i>irredeemable</i> non-cumulative preference shares. "Irredeemable" for the purpose of this item means that the shares are irredeemable or irredeemable except with the <i>prior consent</i> of the Monetary Authority (MA).
(c) & (d)	<u>Share premium and Published reserves</u> 8. Report the institution's share premium account in item (c), and published reserves in item (d) excluding: <ul style="list-style-type: none">• reserves reported in item (e) of Category I and items (h) to (k) of Category II of Part II(a);• unrealized fair value gains or losses on revaluation of loans designated as <i>available-for-sale</i>;• cumulative fair value gains or losses on the hedged items and the hedging instrument in respect of <i>cash flow hedges</i> created for available-for-sale financial instruments and financial instruments that are measured at amortized cost; and• cumulative fair value gains or losses on the hedging instrument that are recognized directly in equity through the statement of changes in equity in respect of cash flow hedges created for <i>forecast transactions</i>. 9. The amount to be included under item (d) as at a particular date shall be net of dividends proposed or declared by the institution after that date; and which, as at that date, are recognized or required to be recognized as equity on the institution's balance sheet.

(e)
(e)(i)

Profit and loss account

Fair value gains arising from equities and debt securities designated at fair value through profit or loss (in core capital)

10. Subject to paragraph 11, report in item (e) the institution's unaudited profit or loss of the current financial year and the institution's profit or loss of the immediately preceding financial year pending audit completion, except those reported in items (h) to (k) of Category II of Part II(a). Any unrealized fair value gains or losses on (i) loans designated at fair value through profit or loss; and (ii) financial liabilities arising from changes in the institution's own creditworthiness, without deduction of deferred tax provisions attributable to such gains or losses, should also be excluded from item (e).
11. The institution may, with the prior consent of the MA, include in item (e) unrealized fair value gains arising from holdings of equities and *debt securities* designated at fair value through profit or loss in its profit and loss account, subject to the institution being able to satisfy the MA that its prudential controls in this area meet the minimum standards as specified by the MA in its SPM [CA-S-9X] "Use of the Fair Value Option for Financial Instruments Fair Value Practices". ~~For record purposes, the institution is required to report in item (e)(i) the amount of fair value gains arising from equities and debt securities designated at fair value through profit or loss which has been included in item (e). Such amount, which are included in the amount reported under item (e), should be separately reported under item (e)(i). Any unrealized fair value gains or losses on (i) loans designated at fair value through profit or loss; and (ii) financial liabilities arising from changes in the institution's own creditworthiness, without deduction of deferred tax provisions attributable to such gains or losses, shall be excluded from the profit and loss account in item (e).~~
12. ~~Institution shall be aware that equities and debt securities designated at fair value through profit or loss do not include~~ Amount reported in item (e)(i) should not include fair value gains arising from the institution's holdings of equities and debt securities that are classified as held for trading. Unless otherwise required by the MA, Any fair value changes arising from the institution's holding of equities and debt securities that are classified as held for trading shall continue to be recognized in the profit or loss account in line with accounting standards included in item (e). Institution shall also be aware that the SPM CA S 9 is applicable only

~~for the institution's holdings of equities and debt securities which are recognized as "assets" on the institution's balance sheet. Any unrealized fair value gains or losses on financial instruments recognized as "liabilities" designated at fair value through profit or loss on the institution's balance sheet shall be excluded from the profit and loss account in item (e).~~

13. Institution shall set aside or earmark from the current year's profit and loss account allowances and provisions for major items such as bad debts, tax, depreciation and audit fees at least on a quarterly basis.
14. The amount to be included in item (e) as at a particular date shall be net of any dividends proposed or declared by the institution after that date; and which, as at that date, are recognized or required to be recognized as equity on the institution's balance sheet.

(f) Minority interests (in core capital)

15. Where the MA requires under section 98(2) of the Banking Ordinance the CAR of the institution is to be calculated on a **consolidated basis** in respect of a subsidiary of the institution, report in item (f) minority interests in the equity of the institution's consolidated subsidiaries, excluding minority interests that are not freely transferable to the institution or members of the **group of companies** of which the institution is a member, after taking into account any relevant regulatory, legal or taxation constraints on the transfer of capital.
16. The minority interests arising on consolidation in the paid-up irredeemable non-cumulative preference shares of the institution's subsidiaries which are **special purpose vehicles** (SPVs) shall not exceed 15% of (A), the institution's core capital (including such minority interests) after making the deductions reported in items (g)(i) to (g)(iv) of Part II(a) but before making the deductions specified in Part II(b) below. Please refer to SPM CA-S-6 for detailed requirements on the special features of these instruments.
17. The amount reported under this item as at a particular date shall be net of dividends proposed or declared by the institution's subsidiaries after that date; and which as at that date, are recognized or required to be recognized as equity on the subsidiaries' balance sheets.
18. The institution can refer to **Annex II-A** for an example on how to calculate the 15% limit on the paid-up irredeemable non-cumulative preference shares of the institution's

subsidiaries which are SPVs as specified in paragraph 16 above.

19. In general, the institution shall adopt accounting treatments that are consistent with the requirements of the Rules in determining minority interests attributable to it for the determination of capital base. Those institutions that have difficulty in doing so should consult the MA in advance. In these circumstances the MA may consider permitting the institution to adopt an alternative treatment, taking into account the materiality of such interests on an aggregate basis.

Deductions from Core Capital

(g)(i) & (g)(ii)

Goodwill and Other Intangible Assets

20. Report the amount of goodwill in item (g)(i) and other items reported as intangible assets in item (g)(ii).

(g)(iii)

Net deferred tax assets

21. Report the amount of net deferred tax assets of the institution.

(g)(iv)

Securitization exposures subject to deduction

22. Report the sum of:

- (i) the amount of any *gain-on-sale* arising from a *securitization transaction* (whether held in the banking book or trading book) in which the institution is the *originating institution*; and
- (ii) any other *securitization exposure* (whether held in the banking book or trading book) specified by the MA in a notice in writing given to the institution.

23. The amount to be reported in item (g)(iv) of Part II(a) should be consistent with the sum of the figures reported in item B.6(a) under “total amount” column of Division I of Part III and item B.4(a) under “Total” column of Division A.1(b) of Part IV.

(g)(v)

Valuation adjustments

24. Where the application of [paragraphs 4.5 of the SPM module on “Financial Instrument Fair Value Practices” (CA-S-X)] has led to a lower carrying values than actually recognized

under the current financial reporting standards as a result of valuation adjustments made, the absolute value of the difference should be reported in item (g)(v).

Core Capital (A)

24.25. This is the sum of items (a) to (f) in Column 2 after making the deductions specifically required from core capital (items (g)(i) to (g)(~~iv~~v)) but **before** making the deductions specified in Part II(b) below and reported in item (B).

Deductions specified in Part II(b) (B)

25.26. This refers to the amount of deductions specified in Part II(b) below and required to be deducted from core capital (A).

26.27. If supplementary capital (D) is less than or equal to 0, then amount to be reported in (B) shall be 100% of the total deductible items (TDI) specified in part II(b) below.

27.28. If supplementary capital (D) is greater than 0, and:

- if 50% of the TDI specified in part II(b) is less than or equal to (D), then amount to be reported in (B) shall be 50% of the TDI specified in part II(b) below. *(In other words, the amount in (B) is 100% of the TDI minus (E) where (E) is 50% of the TDI in this scenario).*
- if 50% of the TDI specified in part II(b) is greater than (D), then amount to be reported in (B) shall be 50% of the TDI specified in part II(b) below plus the amount of 50% of the TDI which has exceeded (D). *(In other words, the amount in (B) is 100% of the TDI minus (D) in this scenario).*

Total Core Capital (C)

28.29. This is the amount of core capital (A) **after** making the deductions reported in item (B) above.

29.30. Under Part II(a) Category I, all items reported shall be in numeric. All figures input and displayed shall be in integer. Except for items (c), (d), (e) and (f) which could theoretically be less than 0, the remaining items reported shall be greater than or equal to 0.

<u>Item</u>	<u>Nature of item</u>
Category II	Supplementary Capital

(h) Reserves attributable to fair value gains on revaluation of holdings of land and buildings²

30.31. This refers to that part of the institution's reserves that is attributable to fair value gains in profit or loss on revaluation of:

- (i) the institution's holdings of land and buildings other than any land and buildings mortgaged to the institution to secure a debt; and
- (ii) 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 other than any land and buildings mortgaged to the subsidiary to secure a debt.

Provided that:

- (a) the institution has a clearly documented policy on the frequency and method of revaluation of its holdings of land and buildings;
- (b) the institution does not depart from that policy except after consultation with the MA;
- (c) subject to sub-paragraph (d) below, 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 MA that, despite all reasonable efforts, it 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;

² According to sections 29, 30 and 31 of the Rules, the institution is allowed to deduct the net book value of reserves on revaluation of land and buildings which is in excess of the net book value of such reserves as at end-December 1998 or the relevant date from the institution's total risk-weighted amount. Such deductible amount should be reported in item 2.10(ii) of Division A of Form MA(BS)3(I).

- (e) any revaluation of the institution's holdings of land and buildings is approved by the external auditors of the institution and explicitly reported in the institution's audited accounts; and
- (f) the revaluation gains relating to paragraphs ~~31(i)30(i)~~ and ~~31(ii)30(ii)~~ above are recognized according to relevant accounting standards. Any such revaluation gains not recognized on the balance sheet shall be excluded.

~~31.32.~~ 32.32. The amount of the fair value gains on revaluation of each of paragraph 31(i) and ~~31(ii)30(i) and 30(ii)~~ above, which may be included in supplementary capital, shall not exceed 45% of each of such fair value gains (i.e. applying a haircut of 55% to each of such gains) and after applying the 55% haircut, shall not exceed the respective amounts that were included in the institution's supplementary capital as at 31 December 1998 if the institution was an authorized institution on that date; or in any other case, the date after 31 December 1998 (i.e. the "relevant date").

~~32.33.~~ 33.33. For the purpose of paragraph ~~3234~~, for the institution which became an authorized institution after 31 December 1998, the respective amounts in paragraphs 31(i) and 31(ii)30(i) and 30(ii) will be based on those included in supplementary capital as at the "relevant date". The relevant date means the date after 31 December 1998 on which the institution became an authorized institution. The respective amounts in paragraphs 31(i) and 31(ii)30(i) and 30(ii) refer to those reserves / fair value gains included in supplementary capital reported by the institution in the CAR Return submitted to the MA upon the application of authorization. supplementary capital as at 31 December 1998 or relevant date, has the meaning assigned to it by the Third Schedule to the Banking Ordinance as in force on 31 December 1998 if the institution was an authorized institution on that date, or as in force on the relevant date in any other case if, and only if, the relevant date is a date before the date on which Part 3 of the Rules comes into operation.

~~33.34.~~ 34.34. The institution is not allowed to include any fair value gains on revaluation of each of paragraph 31(i) and 31(ii)30(i) and 30(ii) above in determining its capital base unless:

- (i) such gains as at 31 December 1998, or in any other case, the date after 31 December 1998 (i.e. relevant

date) on which the institution became an authorized institution, were reported to the MA; or

- (ii) the gains arise from a merger or acquisition and the institution has the prior consent of the MA to use such gains.

34.35. The institution shall not, in calculation of its supplementary capital, set-off losses in respect of the institution's own use property where such losses are recognized in the institution's profit or loss against unrealized gains that are reflected directly in the institution's equity through the statement of changes in equity.

35.36. The institution shall deduct from its core capital any cumulative losses of the institution in respect of its holdings of land and buildings below the depreciated cost value of such land and buildings, irrespective of whether the land and buildings are held for own-use by the institution or for investment purposes.

36.37. For the purposes of item (h), reserves attributable to fair value gains on revaluation of the institution's holdings of land and buildings shall be without deduction of deferred tax provisions attributable to such reserves. Also, "reserves" includes any shares issued by the institution through capitalizing reserves falling within the revaluation reserves referred to in paragraphs 31(i) and 31(ii)~~30(i) and 30(ii)~~ above.

- (i)(i) Reserves attributable to fair value gains on revaluation of holdings of available-for-sale equities and debt securities
- (i)(ii) Unrealized fair value gains arising from holdings of equities and debt securities designated at fair value through profit or loss (in supplementary capital)

37.38. This comprises that part of the institutions' reserves that is attributable to fair value gains on revaluation of its holdings of available-for-sale equities and debt securities. This also includes unrealized fair value gains arising from holdings of equities and debt securities designated at fair value through profit or loss in the event that the institution fails to satisfy the MA that its prudential controls in this area meet the minimum standards specified by the MA in the SPM referred to in paragraph 11 above. In that case, the institution shall exclude such unrealized fair value gains arising from holdings of equities and debt securities designated at fair value through profit or loss from its profit and loss account in item (e) of Category I above and report

such unrealized fair value gains in item (i)(ii) of Category II. As mentioned in paragraph 12 of this instruction, institution shall be aware that equities and debt securities designated at fair value through profit or loss do not include equities and debt securities that are classified as held for trading.

~~38.39.~~ For the part of the institution's reserves attributable to fair value gains on revaluation of the institution's holdings of any other *financial assets not held for trading purposes*, including such assets (other than unrealized gains or losses on loans) that are available-for-sale or designated at fair value through profit or loss, the institution shall seek the MA's prior consent before inclusion of such fair value gains in the supplementary capital.

~~39.40.~~ For the purposes of paragraph ~~3837~~, the amount of reserves to be included in this section shall not exceed 45% of the fair value gains arising from revaluation of the institution's holdings of available-for-sale equities and debt securities (reported in item (i)(i)) and such fair value gains arising from equities and debt securities designated at fair value through profit or loss (reported in item (i)(ii)).

~~40. The institution is required to deduct from its core capital:~~

41. ~~The institution is required to deduct from its core capital cumulative unrealized losses of the institution's holdings of available-for-sale equities and debt securities. The institution shall not set-off unrealized gains against impairment losses in respect of those securities (i.e. impairment losses of those securities should be recognized in Core Capital in full).~~

~~(i) Cumulative unrealized losses of the institution in respect of its holdings of available for sale equities and debt securities and which fall below the cost of such securities; and~~

~~(ii) Impairment losses in respect of the institution's holdings of available for sale equities and debt securities. Institution shall not set off impairment losses against unrealized gains in respect of such securities.~~

~~An overall deficit on revaluation of the institution's holdings of available for sale equities and debt securities shall be deducted from the institution's supplementary capital and reported in item (i)(i) with a negative sign. Such deduction from supplementary capital shall exclude those cumulative unrealized losses or impairment losses in respect of the~~

~~institution's holdings of available for sale equities and debt securities which have already been deducted from the institution's core capital as mentioned above.~~

41.42. For the purpose of items (i)(i) and (i)(ii), reserves / fair value gains on revaluation of the institution's holdings of available-for-sale equities and debt securities or equities and debt securities designated at fair value through profit or loss shall be without deduction of deferred tax provisions attributable to such reserves / fair value gains.

(j), (k) & (l)

Regulatory reserve for general banking risks and collective provisions³

42.43. For the institution which uses the *STC approach* or *BSC approach*, or both, to calculate its credit risk, report *regulatory reserve* for general banking risks in item (j) and *collective provisions* in item (k).

43.44. Subject to paragraphs 4544 and 4645 below, the institution adopting the STC approach or BSC approach, or both, shall only include that amount of its total regulatory reserve for general banking risks and collective provisions in its supplementary capital up to a limit of 1.25% of its total *risk-weighted amount* for relevant risks and report in item (l). For the purposes of determining the 1.25% limit, total risk-weighted amount for relevant risks means the sum of all the institution's risk-weighted amounts for:

- (i) the institution's non-securitization exposures to credit risk subject to the STC approach or BSC approach, or both;
- (ii) the institution's securitization exposures to credit risk subject to the *STC(S) approach*;
- (iii) the institution's exposures to market risk; and
- (iv) the institution's exposure to operational risk.

44.45. For the institution which uses any combination of the STC approach, BSC approach and *IRB approach* –

³ According to sections 29, 30 and 31 of the Rules, the institution is allowed to deduct the portion of its total regulatory reserve for general banking risks and collective provisions apportioned to the STC approach or BSC approach, or both, and STC(S) approach which is not included in supplementary capital from the institution's total risk-weighted amount. Such deductible amount should be reported in item 2.10(i) of Division A of Form MA(BS)3(I).

- (i) subject as set out in sub-paragraph (ii) below, the institution shall 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 according to the proportion of the institution's risk-weighted amount for credit risk which are calculated using the STC approach, BSC approach, IRB approach, **STC(S) approach** or **IRB(S) approach**, as the case requires;
- (ii) the institution may, with the prior consent of the MA, uses 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;
- (iii) the institution shall, after it has carried out the apportionment referred to in sub-paragraph (i) or (ii) –
 - (a) comply with paragraph 4443 above in respect of that portion of its 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;
 - (b) exclude from its supplementary capital (i.e. exclude from items (j), (k) and (l)) 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. The institution shall apply paragraph 4645 below to calculate the adjustment necessary to the core capital and/or supplementary capital in respect of the portion of its total regulatory reserve for general banking risks and collective provisions which are apportioned to the IRB approach and IRB(S) approach.

(m) Surplus provisions (for institution adopting the IRB approach)

45.46. For the institution adopting the IRB approach –

- (i) subject to paragraph ~~45(iii)(b)~~~~44(iii)(b)~~ and sub-paragraph (ii) below, the institution shall deduct the excess of its **total EL amount** over its **total eligible provisions** equally from the institution's core capital (A)

and supplementary capital (**D**) and report the amount in item (7) under part II(b) below;

- (ii) Where the total EL amount is less than the total eligible provisions, the institution may include the excess of the total eligible provisions over the total EL amount (i.e. the surplus provisions) in its supplementary capital up to 0.6% of its risk-weighted amount for credit risk calculated by using the IRB approach. The amount to be reported in item (m) of Part II(a) should be consistent with the figure reported in item 9 of Division F of Form MA(BS)3(IIIc).

(n) Perpetual subordinated debt

(o) Paid-up irredeemable cumulative preference shares

46.47. These are capital instruments which combined certain characteristics of equity capital and debt. To qualify for inclusion as supplementary capital, the instruments must satisfy the MA that under the terms on which the instruments are to be issued, the following conditions are met and after issue, the following conditions continue to be met:

- in the case of debt instrument, the claims of the lender against the institution are fully subordinated to those of all unsubordinated creditors;
- the debt is not secured against any assets of the institution;
- they are not repayable / redeemable without the prior consent of the MA;
- in the case of debt instrument, the money advanced to the institution is permanently available to it;
- the money advanced to the institution in the case of debt instrument or the money raised by the issue of the shares are available to meet losses without the institution being obliged to cease trading;
- the institution is entitled to defer the payment of interest or dividends where its profitability will not support such payment; and
- if the rate of interest or dividends payable on an instrument is liable to be increased under the terms of the instrument, the rate of interest or dividends will not be increased:

- (i) until the expiry of 10 years from the day when the instrument is issued;
- (ii) more than once; and
- (iii) beyond a limit considered appropriate by the MA.

47.48. Please refer to SPM CA-S-8 for more details of the conditions governing these types of capital instruments. In reporting the amount in item (n) and (o), should the institution recognize perpetual subordinated debt or paid-up irredeemable cumulative preference shares as financial liabilities designated at fair value through profit or loss in the institution's balance sheet in accordance with accounting requirements, the institution shall exclude any such unrealized fair value gains or losses on the perpetual subordinated debt from item (n) or paid-up irredeemable cumulative preference shares from item (o) as appropriate.

(p) Total of (n) + (o)

48.49. This is the sum of items (n) and (o) above.

Term capital instruments

(q) Term subordinated debt

(r) Paid-up term preference shares

49.50. To be eligible as supplementary capital, these instruments must satisfy the MA that under the terms on which the instruments are to be issued, the following conditions are met and after issue, the following conditions continue to be met:

- in the case of debt instrument, the claims of the lender against the institution are fully subordinated to those of all unsubordinated creditors;
- the debt is not secured against any assets of the institution;
- they have a minimum initial period to maturity of over 5 years (even though that period may be subsequently reduced with the prior consent of the MA);
- any instrument repayable / redeemable prior to maturity will not be so repaid / redeemed without the prior consent of the MA; and

- if the rate of interest or dividends payable on an instrument is liable to be increased under the terms of the instrument, the rate of interest or dividends will not be increased:

- (i) until the expiry of 5 years from the day when the instrument is issued;
- (ii) more than once; and
- (iii) beyond a limit considered appropriate by the MA.

50.51. The amounts to be included in the institution's supplementary capital under items (q) & (r) shall be discounted by 20% of the original amount of the instrument, each year during the four years immediately preceding the maturity of such instrument.

51.52. Please refer to SPM CA-S-7 for more details of the conditions governing these types of capital instruments. In reporting the amount in item (q) and (r), should the institution recognize term subordinated debt or paid-up term preference shares as financial liabilities designated at fair value through profit or loss in the institution's balance sheet in accordance with accounting requirements, the institution shall exclude any such unrealized fair value gains or losses on the term subordinated debt from item (q) or term preference shares from item (r) as appropriate.

(s) Total term capital instruments

52.53. This is the sum of items (q) and (r) above.

(t) Eligible value of term capital instruments

53.54. Total eligible amount of term capital instruments to be included in supplementary capital must not exceed, in total, 50% of the institution's core capital (A). If amount reported in item (s) is less than or equal to 50% of core capital (A), then amount to be reported in item (t) shall be the same as that reported in item (s). On the other hand, if amount reported in item (s) is greater than 50% of core capital (A), then amount to be reported in item (t) shall be 50% of core capital (A). The amount of item (s) in excess of the 50% of core capital (A) shall be disregarded for the purposes of determination of capital base.

(u) Minority interests (in Supplementary Capital)

54.55. Report minority interests on consolidation of:

- the paid-up irredeemable cumulative preference shares and paid-up term preference shares of the institution's subsidiaries;
- the paid-up irredeemable non-cumulative preference shares of the institution's subsidiaries which are special purpose vehicles (SPVs) in excess of the amount permitted for inclusion as the institution's core capital (A).

55-56. The amount to be included in item (u) as at a particular date shall be net of any dividends proposed or declared by the institution's subsidiaries after that date; and which, as at that date, are recognized or required to be recognized as equity on the subsidiaries' balance sheets.

Supplementary Capital (D)

56-57. This is the sum of items (h) to (u) in Column 2⁴ **before** making the deductions specified in Part II(b) below which is reported in (E), but limited to 100% of the core capital (A). If the sum of items (h) to (u) in Column 2 is greater than 0, then the amount to be included in (D) shall not exceed the total amount of core capital (A) (i.e. Minimum of ((sum of items (h) to (u) in Column 2, (A))). The amount of the sum of items (h) to (u) in Column 2 in excess of the amount of core capital (A) shall be disregarded for the purposes of determination of capital base. If the sum of items (h) to (u) in Column 2 is equal to 0, then (D) shall be 0. If the sum of items (h) to (u) in Column 2 is less than 0, the institution shall report the amount in (D) with a negative sign.

Deductions specified in Part II(b) (E)

57-58. This refers to the amount of deductions specified in Part II(b) below and required to be deducted from supplementary capital (D).

58-59. If supplementary capital (D) is less than or equal to 0, then amount to be reported in (E) shall be 0.

59-60. If supplementary capital (D) is greater than 0, then amount to be reported in (E) shall be 50% of the total deductible items (TDI) in part II(b) below but limited to

⁴ To be specific, it is referring to the sum of items (h), (i)(i), (i)(ii), (l), (m), (p), (t) and (u) in Column 2.

100% of (D) with the excess amount to be deducted from core capital (A). (In other words, if (D) is less than 50% of the TDI, (E) shall be equal to (D). If (D) is greater than or equal to 50% of the TDI, (E) shall be equal to 50% of the TDI).

Total Supplementary Capital (F)

60.61. This is the amount of supplementary capital (D) **after** making the deductions reported in item (E) above.

Capital Base

Capital Base (G)

61.62. This is the aggregate of Total core capital (C) and Total supplementary capital (F).

62.63. This is also the figure to be reported in item 1 of Division A of Form MA(BS)3(I).

63.64. Under Part II(a) Category II, all items reported shall be in numeric. All figures input and displayed shall be in integer. Except for items (i)(i), (u), (D), (F) and (G) which could theoretically be less than 0, the remaining items reported shall be greater than or equal to 0.

Item

Nature of item

Part II(b)

Deductible Items

64.65. This part sets out the items to be deducted from the institution's core capital and supplementary capital to arrive at the capital base. Subject as specifically provided below, the following deductions shall be made as to 50% from core capital (A) and 50% from supplementary capital (D). Where 50% of the total required deductions (TDI) exceeds the total of the institution's supplementary capital (D), the excess amount shall be deducted from the institution's core capital (A).

65.66. For the purposes of paragraphs 67.66 to 74.73 below, the deduction of the institution's investments in shareholdings (after netting any goodwill relating to such shareholdings that is already deducted from core capital (A) and reported in item (g)(i) in Part II(a) Category I above) shall be deducted from the core capital and supplementary capital in the manner as specified in paragraph 65.64 above.

(1) Shareholdings in holding companies

66.67. Report the amount of the institution's holding of shares in a holding company of the institution.

(2)(i) Investments in subsidiaries and significant investments in non-subsidiary companies

67.68. Report the amount of the institution's holdings of shares and *other regulatory capital instruments* issued by a company in which the institution is entitled to exercise, or control the exercise of, more than 20% of the voting power at any general meeting of that company (and whether or not the company is a subsidiary of the institution), other than:

- (i) where the MA requires under section 98(2) of the Banking Ordinance the CAR of the institution to be calculated on a solo-consolidated or consolidated basis, the institution's holdings of shares and other regulatory capital instruments in the solo-consolidated or consolidated subsidiaries that are included in the consolidation; or
- (ii) the institution's reserves arising from the revaluation of the holdings of land and buildings of a subsidiary of the institution and do not fall within the meaning of reserves under paragraph 37.36.

(2)(ii)

Investments in subsidiary undertakings

~~68.69.~~ Report the amount of the institution's holdings of shares and other regulatory capital instruments in any relevant **subsidiary undertaking** of the institution but excluding any such holdings of shares and other regulatory capital instruments already included under item (2)(i) of Part II(b); or any such holdings which have been excluded from item (2)(i) of Part II(b) by virtue of falling within sub-paragraphs (i) and (ii) of paragraph ~~6867~~ above.

~~69.70.~~ For this purpose, subsidiary undertaking shall be construed in accordance with section 2B of the Companies Ordinance (Cap. 32) as read with the Twenty-Third Schedule to that Ordinance. Relevant subsidiary undertaking means a subsidiary undertaking of the institution which does not fall within the range of consolidation specified in a notice under section 98(2) of the Banking Ordinance which relates to the institution but does fall within the range of consolidation specified in accounting standards issued by the Council of the Hong Kong Institute of Certified Public Accountants pursuant to section 18A of the Professional Accountant Ordinance (Cap. 50).

(3)

Investments in other banks

~~70.71.~~ Report the amount of institution's holdings of shares and other regulatory capital instruments issued by any bank (other than the amounts already included under items (1), (2)(i) or (2)(ii) above) unless the MA is satisfied that the holding is not the subject of an arrangement in which two or more persons agree to hold each other's capital or is not otherwise a strategic investment.

(4)

Exposures to connected companies

~~71.72.~~ Report the amount of the institution's loans to, holdings of shares and **debentures** issued by, and guarantees of the liabilities of, connected companies of the institution (other than the amounts already included under items (1), (2)(i), (2)(ii) or (3) above), unless the institution demonstrates to the satisfaction of the MA that the loan was made, the shares and debentures are being held, or the guarantees was given, as the case may be, in the ordinary course of the institution's business.

~~72.73.~~ For the purposes of item (4), "shares" and "debentures" mean shares and debentures within the meaning of section

2(1) of the Companies Ordinance (Cap. 32)⁵, and a company shall be treated as a *connected company* of the institution if it is a subsidiary or the holding company of the institution, or is a company which falls within section 64(1)(b), (c), (d) or (e) of the Banking Ordinance in respect of the institution.

(5) Other significant investments in shares

73.74. Report the amount of the institution's holding of shares in any company (other than the amounts already included under items (1), (2)(i), (2)(ii), (3) or (4) above) where the book value of the holdings exceeds 15% of the capital base of the institution, in such case the portion of the shareholding that exceeds this 15% threshold shall be deducted. For this purpose, the institution shall make reference to the capital base reported in the institution's CAR Return as at the immediately preceding calendar quarter end date in determining the portion of shareholding that exceeds the 15% threshold.

(6) Capital shortfall of regulated non-bank subsidiaries

74.75. Report the amount of any relevant capital shortfall, as measured by the relevant regulator's requirements and specified in a written notice issued by the MA to the institution, in respect of any subsidiary of the institution which is a securities firm or an insurance firm and which is not the subject of consolidation required by the MA under section 98(2) of the Banking Ordinance.

75.76. No recognition of any surplus capital in any subsidiary of the institution, which is a securities firm or an insurance firm, is allowed for the purposes of determining the institution's capital base and calculating the institution's CAR.

76.77. The capital shortfall amount to be reported in item (6) and be deducted as to 50% from core capital (**A**) and 50% from supplementary capital (**D**) is in addition to any other deduction the institution is required to make under items (1) to (5) above, as applicable, from its core capital and supplementary capital in respect of the subsidiary concerned of the institution, and represents the amount by which the subsidiary is deficient in meeting its own minimum capital requirement.

⁵ "share" means share in the share capital of a company, and includes stock except where a distinction between stock and shares is expressed or implied.

"debenture" includes debenture stock, bonds and any other securities of a company whether constituting a charge on the assets of the company or not.

~~77.78.~~ For the avoidance of doubt, the institution's investment in any of its subsidiary securities and/or insurance firms which are subject to deduction under items (1) to (5) above, as applicable, shall be net of any goodwill relating to such investment in subsidiary securities and/or insurance firms which is already deducted from core capital (A) and reported in item (g)(i) in Part II(a) Category I above.

(7) Excess of total EL amount over total eligible provisions under the IRB approach

~~78.79.~~ For the institution adopting the IRB approach to calculate its credit risk, report the excess amount of total EL amount over total eligible provisions as calculated under paragraph ~~46(i)45(i)~~. The amount to be reported in item (7) of Part II(b) should be consistent with the figure reported in item 6 of Division F of Form MA(BS)3(IIIc).

(8) EL amount of equity exposure under the PD/LGD approach

~~79.80.~~ For the institution adopting the *PD/LGD approach* to calculate its credit risk in respect of equity exposures, report the *EL amount* of such exposures as calculated in accordance with the rules specified in Part 6 of the Rules for the IRB approach.

(9) Other amounts deductible from core capital and supplementary capital

~~80.81.~~ Report the other amounts required to be deducted from the core capital and supplementary capital of the institution. The list of such items is set out in Schedule 5 of the Rules and is recapped in Annex II-B for ease of reference. Item (9) is the sum of the following:

- item (9)(i): the first loss portion of a credit protection in respect of the institution's exposures (applicable to STC approach or BSC approach);
- item (9)(ii): amounts related to non-delivery versus payment failed transactions subject to deduction (applicable to STC approach, BSC approach or IRB approach); ~~and~~
- item (9)(iii): securitization exposures subject to deduction (applicable to STC(S) approach or IRB(S) approach). The amount to be reported in this item should be consistent with the sum of the figures reported

in item B.6(b) under “total amount” column of Division I of Part III; and item B.4(b) under “Total” column of Division A.1(b) of Part IV.

Total

Total deductible items (TDI)

81.82. This is the sum of items (1) to (9) of Part II(b) in Column 2, the amount of which shall be deducted from the institution’s core capital and supplementary capital (i.e. (A) & (D)) in accordance with paragraph 6564 above.

82.83. Under Part II(b), all items reported shall be in numeric and greater than or equal to 0. All figures input and displayed shall be in integer.

Hong Kong Monetary Authority

March 20072012

Illustration for the calculation of the 15% limit on the paid-up irredeemable non-cumulative preference shares of the institution's subsidiaries which are SPVs

1. As specified in paragraph 16, the minority interests arising on consolidation in the paid-up irredeemable non-cumulative preference shares of the institution's subsidiaries which are SPVs shall not exceed 15% of the institution's total core capital (including such minority interests) after making the deduction reported in items (g)(i) to (g)(~~iv~~v) of Part II(a) but before making the deductions specified in Part II(b).

2. To determine the allowable amount for inclusion in core capital, the institution should apply a factor of 17.65% to the sum of the capital items under items (a) to (f) Category I of Part II(a) to be included as core capital (excluding the minority interests arising on consolidation in the paid-up irredeemable non-cumulative preference shares of the institution's subsidiaries which are SPVs) (referred to as "core capital instruments" thereafter) after making the deduction specified in items (g)(i) to (g)(~~iv~~v) of Part II(a) but before making the deductions specified in Part II(b). The factor of 17.65% is derived from the proportion of 15% to 85% (i.e. $15\% \div 85\% = 17.65\%$).

3. Assume the institution's amount of core capital instruments after making the deduction specified in items (g)(i) to (g)(~~iv~~v) of Part II(a) but before making the deductions specified in Part II(b) is HK\$85 million. The allowable amount of minority interests arising on consolidation in the paid-up irredeemable non-cumulative preference shares of the institution's subsidiaries which are SPVs for inclusion in core capital will be HK\$85 million x 17.65% = **HK\$15 million**. Therefore, the institution's total core capital (including such minority interests) after making the deduction specified in items (g)(i) to (g)(~~iv~~v) of Part II(a) but before making the deductions specified in Part II(b) will amount to HK\$ (85 + 15) million = HK\$100 million. It follows that the minority interests arising on consolidation in the paid-up irredeemable non-cumulative preference shares of the institution's subsidiaries which are SPVs will account for 15% (i.e. $\text{HK\$15 million} \div \text{HK\$100 million} = 15\%$) of the institution's Total core capital (including such minority interest).

Other amounts deductible from core capital and supplementary capital

<u>Item</u>	<u>Nature of item</u>
Part II(b), 9(i)	<p><u>First loss portion of the credit protection</u></p> <ol style="list-style-type: none">1. In relation to the institution which uses the STC approach, the amount of the first loss portion of a credit protection in respect of the institution's exposures as specified in section 101(2) or (8)(c) of the Rules.2. In relation to the institution which uses the BSC approach, the amount of the first loss portion of a credit protection in respect of the institution's exposures as specified in section 135(2) or (8)(c) of the Rules.
Part II(b), 9(ii)	<p><u>Risk of loss arising from unsettled non-delivery versus payment (non-DvP) transactions</u></p> <ol style="list-style-type: none">3. In relation to the institution which uses the STC approach, BSC approach or IRB approach, the amount of the sum of –<ol style="list-style-type: none">(i) the amount of payment made by, or the current market value of the thing delivered by, the institution in respect of any transaction in securities (other than a <i>repo-style transaction</i>), or any transaction in foreign exchange and commodities, which –<ol style="list-style-type: none">(A) was entered into on a basis other than a <i>delivery-versus-payment basis</i>; and(B) has remained unsettled after the contractual date of payment or delivery to the institution for 5 or more <i>business days</i>; and(ii) the amount of any <i>positive current exposure</i> associated with the transaction referred to in sub-paragraph (i).
Part II(b), 9(iii)	<p><u>Securitization exposures subject to deduction</u></p> <ol style="list-style-type: none">4. In relation to the institution which uses the STC(S) approach, the amount of the sum of the items falling within section 236(1)(a), (c), (d) or (e) of the Rules.

5. In relation to the institution which uses the IRB(S) approach, the amount of the sum of the items falling within section 251(1)(a), (c), (d), (e) or (f) of the Rules.

6. In relation to the institution which is subject to Part 8 of the Rules, the amount of the sum of the items falling within –

(i) section 236(1)(a), (c), (d), (da) or (e) or 251(1)(a), (c), (d), (e), (ea) or (f) of the Rules by virtue of the operation of section 287A of the Rules; and

(ii) section 307(5) of the Rules.