HONG KONG MONETARY AUTHORITY
香港金融管理局

Banking Policy Department *銀行政策部*

Our Ref.: B4/9C & B9/128C

12 November 2014

Mr Lee Huat Oon
Acting Chairman
The DTC Association
Unit 1704, 17/F, Bonham Trade Centre
50 Bonham Strand East
Sheung Wan
Hong Kong

By email & by hand

Dear Mr Lee,

Consultation on Supervisory Policy Manual (SPM)
"Countercyclical Capital Buffer (CCyB) – Geographic Allocation of Private Sector Credit Exposures"

I am writing to seek the Association's comments on a draft SPM module on the "Countercyclical Capital Buffer (CCyB) – Geographic Allocation of Private Sector Credit Exposures", which the HKMA proposes to issue as a statutory guideline following industry consultation.

As you will be aware, the Banking (Capital) (Amendment) Rules 2014 (BCAR 2014), which incorporate provisions for the imposition of capital requirements arising from the operation of the CCyB, were tabled before the Legislative Council on 29 October and are expected to come into effect on 1 January 2015. The enclosed draft module is intended to provide further guidance to AIs on how to determine the geographic allocation of their private sector credit exposures for the purposes of calculating their specific CCyB rate under the Banking (Capital) Rules as amended by the BCAR 2014.

As set out in the BCAR 2014, an AI must determine its own specific CCyB rate as the weighted average of the applicable jurisdictional CCyB rates in respect of those jurisdictions (including Hong Kong) where the AI has private sector credit exposures. The weight to be attributed to a given jurisdiction's applicable CCyB rate is the ratio of the AI's aggregate risk-weighted amount for its non-bank private sector credit exposures in that jurisdiction (RWA_j) to the sum of the AI's RWA_j across all jurisdictions in which the AI has private sector credit exposure.

The new module sets out the MA's expectations on how an AI should allocate its non-bank private sector credit exposures, and the corresponding risk-weighted amount (RWA), to different jurisdictions on an ultimate risk basis (as required under the BCAR 2014), in order to determine the AI's aggregate risk-weighted amount (RWA_j) for its non-bank private sector credit exposures in each jurisdiction. The module covers:

1. **Determining RWA_j**. As described in Section 2 of the module, for each jurisdiction, RWA_j is the sum of the two components corresponding to each of the following:

   - ***Banking book***. As a general approach, an AI should determine the geographic location of the non-bank private sector credit exposures booked in the AI's banking book by identifying in which jurisdiction the obligor(s) corresponding to each exposure is/are located (if possible on an ultimate risk basis – see para. 2 below). For each identified jurisdiction, the AI should then aggregate the RWA of all non-bank private sector credit exposures whose obligors are located in that jurisdiction. Special cases which include exposures to "pools" of underlying exposures which are located in multiple jurisdictions (i.e. collective investment schemes, securitisation exposures, pools of retail exposures) and specialised lending are dealt with in Section 2.2.2 of the draft module.

   - ***Trading book***. An AI should identify in which jurisdiction the obligor(s) is/are located (if possible on an ultimate risk basis – see para. 2 below) in respect of the AI's exposures which are subject to a market risk capital charge for specific risk. The AI should then apply a different procedure for the purposes of allocating the RWA for specific risk to the various jurisdictions concerned, depending on whether the AI calculates a market risk RWA based on the standardized (market risk) approach (STM approach) or on the internal models approach (IMM approach).

2. **Ultimate risk basis**. As mentioned above, an AI is expected to identify the geographic location of its obligors, where possible, on an "ultimate risk basis". This means allocating exposures to the jurisdiction where the risk ultimately lies, i.e. where the "ultimate obligor" resides. Section 3 of the module provides guidance on how to apply this principle.

I would be grateful if the Association's comments on the draft module could reach us by 15 December 2014. Should you have any questions regarding the enclosed draft module, please feel free to contact Mr Noel Sacasa (njsacasa@hkma.gov.hk) or Mr Rocco Huang (rrhuang@hkma.gov.hk).

I am writing in similar terms to The Hong Kong Association of Banks.

Yours sincerely,

Karen Kemp
Executive Director (Banking Policy)

Encl.

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