



Supervisory Policy Manual

CR-L-4

**Underwriting of Securities:
BELR**

V.2 – 27.12.19

This module should be read in conjunction with the [Introduction](#) and with the [Glossary](#), which contains an explanation of abbreviations and other terms used in this Manual. If reading on-line, click on blue underlined headings to activate hyperlinks to the relevant module.

Interpretation

In this module:

- **BELR** means the Banking (Exposure Limits) Rules (Cap. 155S)

Purpose

To govern the underwriting business of AIs and explain the MA's policy towards the underwriting and sub-underwriting of securities by AIs in relation to Parts 2, 3 and 7 of the BELR¹

Classification

A statutory guideline issued by the MA under the Banking Ordinance, §7(3)

Previous guidelines superseded

Guideline 5.2.4 "Underwriting of Securities: §§81 and 87" dated 13.10.91;
CR-L-4 (V.1) "Underwriting of Securities: §§81 and 87" dated 31.08.01

Application

To all locally incorporated AIs

Structure

1. Application
 - 1.1 General

¹ The guidance of this module may have indirect impact on Part 8 which cross-reference to the exposure calculation under Part 7.



Supervisory Policy Manual

CR-L-4

Underwriting of Securities: BELR

V.2 – 27.12.19

2. Regulatory policy
 - 2.1 Supervisory approach
 - 2.2 Underwriting policy
 - 2.3 Maximum underwriting commitments
 3. Statutory requirement
 - 3.1 Limit on exposure to single counterparty and group of linked counterparties
 - 3.2 Limit on equity exposure
 - 3.3 Limit on acquisition of share capital of company
 - 3.4 Seven day exemption period
 - 3.5 Policy on extension of exemption period
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1. Application

1.1 General

- 1.1.1 This module applies to an AI that undertakes or intends to enter into the underwriting business.
- 1.1.2 It covers underwriting and subunderwriting activities which give rise to commitments under a contractual agreement in respect of new securities and existing securities, where the AI will only be called upon to purchase the securities if end-investors or sub-underwriters fail to do so.
- 1.1.3 It does not cover “bought deals” where the AI acquires the securities from the outset as a principal for subsequent sale in the market or “block trades” in the secondary market. Holdings of securities in these circumstances will form part of an exposure covered by Part 7 of the BELR and if the securities in question are shares, an equity exposure under Part 2 and share acquisition under Part 3 of the BELR.

2. Regulatory policy



Supervisory Policy Manual

CR-L-4

Underwriting of Securities: BELR

V.2 – 27.12.19

2.1 Supervisory approach

2.1.1 An AI is expected to have adequate and effective internal controls over its underwriting business. The HKMA may review the relevant internal control systems and processes in the course of undertaking its risk-based supervisory processes.

2.2 Underwriting policy

2.2.1 Any AI wishing to engage in underwriting activity should prepare an underwriting policy which has to be approved by its Board of Directors. The policy will need to contain, inter alia:

- approved types of underwriting transactions;
- individual and aggregate limits applying to underwriting commitments. Such limits should also take account of cases where the AI has other financial exposures to the counterparty concerned (see sub-section 2.3 for details);
- where no such limits are in place but transactions are to be approved case by case, clear instructions about the type and size of transactions which will be contemplated;
- arrangements applying to the sub-underwriting of commitments taken on by the AI, including the degree of commitment which should be obtained from the sub-underwriter; and
- arrangements for the disposal of securities acquired under an underwriting contract, in particular to avoid a financial exposure exceeding 25% of Tier 1 capital after the exemption period (see paragraph 3.1.1).

2.2.2 It is not necessary to agree the underwriting policy (including the maximum underwriting commitments set out in the next paragraph) with the HKMA in advance. However, as mentioned above these are subject to review in the course of the HKMA's risk-based supervisory processes.



Supervisory Policy Manual

CR-L-4

Underwriting of Securities: BELR

V.2 – 27.12.19

2.3 Maximum underwriting commitments

2.3.1 The underwriting policy should include the maximum size and type of underwriting and sub-underwriting transactions, measured on an aggregate basis per issuer, that an AI can take on. An AI may also establish limits for different categories of issuers, e.g. according to their credit ratings.

2.3.2 The limits will apply to the maximum amount of securities an AI is committed to taking up, i.e. after deduction of amounts to be sub-underwritten by other parties under firm and binding agreements.

2.3.3 In formulating the maximum underwriting commitment allowed, an AI should have regard to:

- types of securities to be underwritten - for example, the limits should reflect the relative risks of different types of securities and issuers (with reference to their credit ratings where applicable);
- the AI's underwriting expertise and previous experience and track record (e.g. whether it has been "stuck" with any issues);
- the AI's capability to dispatch and dispose of the issue (including "stuck position") such as market standing, placing network, etc.; and
- risk control systems in place.

2.3.4 Monitoring of the maximum underwriting commitment to a particular issuer should take into account the aggregate amount of underwriting commitment incurred against the issuer at any point of time.

3. Statutory requirement

3.1 Limit on exposure to single counterparty and group of linked counterparties

3.1.1 Part 7 of the BELR limits a locally incorporated AI's aggregate exposures to a single counterparty or group of



Supervisory Policy Manual

CR-L-4

Underwriting of Securities: BELR

V.2 – 27.12.19

linked counterparties to 25% of its Tier 1 capital. Aggregate exposures include the value of an AI's holdings of shares, debentures and other debt securities issued by these parties (see subsection 2.3 of [CR-G-8](#) "Large Exposures and Risk Concentrations").

3.1.2 Among the exemptions available under the BELR, Rule 48(1)(f) provides that any exposures arising from any share capital or debt securities acquired under an underwriting or sub-underwriting contract can be excluded, for up to seven working days, from calculation of an AI's exposure for the purposes of the 25% limit. The MA may give written approval for longer periods and, if the MA thinks proper, attach conditions to such approval.

3.2 Limit on equity exposure

3.2.1 Part 2 of the BELR provides that a locally incorporated AI's aggregate equity exposure should not exceed 25% of its Tier 1 capital.

3.2.2 An exemption from the equity exposure limit similar to Rule 48(1)(f) of the BELR is available under Rule 14(1)(c) of the BELR.

3.3 Limit on acquisition of share capital of company

3.3.1 Part 3 of the BELR provides that a locally incorporated AI must not, except with a consent given by the MA, acquire all or part of the share capital of a company to a value equivalent to 5% or more of the amount of the AI's Tier 1 capital at the time of the acquisition.

3.3.2 An exemption from calculation towards the 5% limit similar to that of Rule 48(1)(f) of the BELR is available under Rule 23(2)(a)(ii) of the BELR.

3.4 Seven day exemption period

3.4.1 The seven day exemption period available under Rules 14, 23 and 48 of the BELR runs from the time when an AI acquires the securities being underwritten.

3.4.2 The main reasons for the short exemption period are to



Supervisory Policy Manual

CR-L-4

Underwriting of Securities: BELR

V.2 – 27.12.19

make the HKMA aware of an exposure at an early stage and to deter AIs from taking on too large underwriting commitments with which they may not have the necessary experience, skills and systems in place to deal.

- 3.4.3 The MA has discretion to approve a longer exemption period beyond seven working days, and may attach conditions to such approval.

3.5 Policy on extension of exemption period

- 3.5.1 The HKMA expects that an AI which does not intend to maintain the securities acquired from its underwriting commitment should endeavour to dispose of the holdings by the end of the seven-day exemption period. The HKMA will consider approving extension of the exemption period only in special situations, including:

- (a) operations of the AI to dispose the securities have been disrupted by unanticipated incidents during the seven-day exemption period, e.g. typhoon, system failure, etc.
- (b) extreme market condition has been causing any fire sales of the securities not being able to realize their "fair value". An extension is warranted because fire sales of the securities may not be in the best interests of the depositors.
- (c) any other situations considered acceptable by the MA.

- 3.5.2 In the above situations, an AI may write to its usual contact at the HKMA to apply for the MA's approval to hold the securities beyond the seven-day exemption period. The MA will consider giving an approval that normally does not exceed three months.

[Contents](#)

[Glossary](#)

[Home](#)

[Introduction](#)