**Annex 4**

# Illustration of the 3-Step Approach to Balance Sheet Reconciliation

## (figures used for illustrative purpose only)

### Step 1

Under Step 1, an AI must use its balance sheet in its published financial statements based on the accounting scope of consolidation (2nd column below) as a starting point and report the amount for each item in the published financial statements based on the regulatory scope of consolidation (3rd column below). If there are items in the balance sheet under the regulatory scope of consolidation that are not present in the published balance sheet, the AI must add rows to cover them in the reconciliation and report zero in the 2nd column.

| **(Condensed balance sheet for illustrative purpose)** | **Balance sheet as in published financial statements** | **Under regulatory scope of consolidation** |
|---|---|---|
| (in Millions) | **As at period end** | **As at period end** |
| **Assets** | | |
| Cash and due from banks | 12,000 | 11,000 |
| Interest-bearing deposits with banks | 15,000 | 13,000 |
| Securities | 50,000 | 45,000 |
| Repurchase agreements and other similar secured lending | 1,000 | 1,000 |
| Loans | | |
| - Retail | 255,000 | 251,000 |
| - Wholesale | 250,000 | 249,000 |
| Investments for account of segregated fund holders | 357 | 0 |
| Other | | |
| - Derivatives | 20,000 | 20,000 |
| - Other assets | 81,180 | 81,180 |
| **Total assets** | **684,537** | **671,180** |
| | | |
| **Liabilities** | | |
| Deposits | 448,180 | 435,180 |
| Insurance and investment contracts for account of segregated fund holders | 357 | 0 |
| Other | | |
| - Derivatives | 55,000 | 55,000 |
| - Other liabilities | 114,000 | 114,000 |
| Provisions | 5,000 | 5,000 |
| Subordinated debt | 10,000 | 10,000 |
| Irredeemable non-cumulative preference shares | 5,000 | 5,000 |
| **Total liabilities** | **637,537** | **624,180** |
| **Shareholders' Equity** | | |
| Equity attributable to shareholders | 46,100 | 46,100 |
| Non-controlling interests | 900 | 900 |
| **Total shareholders' equity** | 47,000 | 47,000 |
| **Total liabilities and shareholders' equity** | **684,537** | **671,180** |

## Step 2

Under Step 2, an AI must expand the balance sheet under the regulatory scope of consolidation to identify all the capital components that are reported in the Capital Disclosures Template set out in Annex 1, or the Transition Disclosures Template set out in Annex 2, as applicable. Each capital component should be given a number in the 4th column that can be used as a cross-reference as explained in Step 3. The AI is only required to expand the balance sheet to the extent necessary for all of the applicable capital components to be included (i.e. the more complex the balance sheet of the AI, the more items would need to be disclosed.

An AI should report deductions from capital as positive numbers, and additions to capital as negative numbers.

| **(Condensed balance sheet for illustrative purposes)** | **Balance sheet as in published financial statements** | **Under regulatory scope of consolidation** | **Cross reference to Definition of Capital Components** |
|---|---|---|---|
| | **As at period end** | **As at period end** | |
| **Assets** | | | |
| Cash and due from banks | 12,000 | 11,000 | |
| Interest-bearing deposits with banks | 15,000 | 13,000 | |
| Securities | 50,000 | 45,000 | |
| *of which: insignificant capital investments in financial sector entities exceeding 10% threshold* | | 1,000 | **(1)** |
| Repurchase agreements and other similar secured lending | 1,000 | 1,000 | |
| Loans | | | |
| - Retail | 255,000 | 251,000 | |
| - Wholesale | 250,000 | 249,000 | |
| Investments for account of segregated fund holders | 357 | - | |
| Other | | | |
| - Derivatives | 20,000 | 20,000 | |
| - Other assets | 81,180 | 81,180 | |
| *of which: goodwill* | | 5,000 | **(2)** |
| *other intangible assets* | | 5,000 | **(3)** |
| *deferred tax assets* | | 2,000 | **(4)** |
| *defined benefit pension fund net assets* | | 1,200 | **(5)** |
| *significant capital investments in financial sector entities exceeding 10% threshold* | | 2,500 | **(6)** |
| **Total assets** | **684,537** | **671,180** | |
| | | | |
| **Liabilities** | | | |
| Deposits | 448,180 | 435,180 | |
| Insurance and investment contracts for account of segregated fund holders | 357 | - | |
| Other | | | |
| - Derivatives | 55,000 | 55,000 | |
| - Other liabilities | 114,000 | 114,000 | |
| *of which : gains and losses due to changes in own credit risk on fair valued liabilities* | | 200 | **(7)** |
| *deferred tax liabilities related to goodwill* | | - | **(8)** |
| *deferred tax liabilities related to intangibles* | | 1,000 | **(9)** |
| *deferred tax liabilities related to defined pension fund net assets* | | 200 | **(10)** |
| *other deferred tax liabilities* | | 300 | **(11)** |
| Impairment allowances | 5,000 | 5,000 | |
| *of which: collective impairment allowances reflected in regulatory capital* | | 500 | **(12)** |
| *Excess of total EL amount over total eligible provisions under the IRB Approach* | | (250) | **(13)** |
| Subordinated debt | 10,000 | 10,000 | |
| *of which: subordinated debt not eligible for inclusion in regulatory capital* | | - | **(14)** |
| *subordinated debt eligible for inclusion in regulatory capital* | | 9,800 | **(15)** |
| Irredeemable non-cumulative preference shares | 5,000 | 5,000 | **(16)** |

| | | | |
|---|---|---|---|
| **Total liabilities** | **637,537** | **624,180** | |
| **Shareholders' Equity** | | | |
| Equity attributable to shareholders | 46,100 | 46,100 | |
| *of which: paid-in share capital* | | 15,100 | **(17)** |
| *retained earnings* | | 26,000 | **(18)** |
| *accumulated other comprehensive income (loss), other than cash flow hedge reserves and forex unrealised gains/losses* | | (450) | **(19)** |
| *cash flow hedge reserves* | | (150) | **(20)** |
| *forex unrealised gains/losses* | | 100 | **(21)** |
| *preferred shares* | | 4,500 | **(22)** |
| *other capital instruments* | | 1,000 | **(23)** |
| Non-controlling interests | 900 | 900 | **(24)** |
| *of which: portion eligible for inclusion in CET1 capital* | | 500 | **(25)** |
| *portion eligible for inclusion in Tier 1 capital* | | 50 | **(26)** |
| *portion eligible for inclusion in Tier 2 capital* | | 50 | **(27)** |
| *portion not eligible for inclusion in regulatory capital* | | 300 | **(28)** |
| **Total shareholders' equity** | 47,000 | 47,000 | |
| **Total liabilities and shareholders' equity** | **684,537** | **671,180** | |

**Step 3**

Under Step 3, an AI must add a column to the Capital Disclosures Template set out in Annex 1, or to the Transition Disclosures Template set out in Annex 2, as applicable, to cross reference figures to those in the 4th column of the expanded balance sheet in Step 2. For the purpose of this illustration, the Transition Disclosures Template is used.

**Extract of Transition Disclosures Template (with added column)**

| | | Component of regulatory capital reported by bank | Amounts subject to pre-Basel III treatment | Cross-referenced* to |
|---|---|---|---|---|
| | **CET1 capital: instruments and reserves** | | | |
| 1 | Directly issued qualifying CET1 capital instruments plus any related share premium | 15,100 | | **(17)** |
| 2 | Retained earnings | 26,000 | | **(18)** |
| 3 | Disclosed reserves and accumulated other comprehensive income | (500) | | **(19) + (20) + (21)** |
| 4 | *Directly issued capital subject to phase out from CET1 capital (only applicable to non-joint stock companies)* | | | |
| | *Public sector capital injections grandfathered until 1 January 2018* | | | |
| 5 | Minority interests arising from CET1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in CET1 capital of the consolidation group) | 500 | | **(25)** |
| 6 | **CET1 capital before regulatory deductions** | **41,100** | | |
| | **CET1 capital: regulatory deductions** | | | |
| 7 | Valuation adjustments | 0 | | |
| 8 | Goodwill (net of associated deferred tax liability) | 5,000 | | **(2) - (8)** |
| 9 | Other intangible assets (net of associated deferred tax liability) | 4,000 | [transition arrangement only available for MSR, if any] | **(3) - (9)** |
| 10 | Deferred tax assets net of deferred tax liabilities | 1,700 | | **(4) - (11)** |
| 11 | Cash flow hedge reserve | (150) | | **(20)** |
| 12 | Excess of total EL amount over total eligible provisions under the IRB approach | 50 | 200 | **(13) - (29) - (30)** |
| 13 | Gain-on-sale arising from securitization transactions | 0 | | |
| 14 | Gains and losses due to changes in own credit risk on fair valued liabilities | 200 | [transition arrangement only available for DVA, if any] | **(7)** |
| 15 | Defined benefit pension fund net assets (net of associated deferred tax liabilities) | 200 | 800 | **[(5) - (10)] x 20%** |
| 16 | Investments in own CET1 capital instruments (if not already netted off paid-in capital on reported balance sheet) | 0 | | |
| 17 | Reciprocal cross-holdings in CET1 capital instruments | 0 | | |
| 18 | Insignificant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold) | 200 | 800 | **(1) - (31) - (32)** |
| 19 | Significant capital investments in CET1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold) | 500 | 2000 | **(6) - (33) - (34)** |
| 20 | Mortgage servicing rights (amount above 10% threshold) | | | |
| 21 | Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability) | | | |
| 22 | Amount exceeding the 15% threshold | | | |
| 23 | of which: significant investments in the common stock of financial sector entities | | | |
| 24 | of which: mortgage servicing rights | | | |
| 25 | of which: deferred tax assets arising from temporary differences | | | |
| 26 | National specific regulatory adjustments applied to CET1 capital | | | |
| 26a | Cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties) | 0 | | |
| 26b | Regulatory reserve for general banking risks | 0 | | |
| 26c | Securitization exposures specified in a notice given by the Monetary Authority | 0 | | |

| | | | | |
|---|---|---|---|---|
| 26d | Cumulative losses below depreciated cost arising from the institution's holdings of land and buildings | 0 | | |
| 26e | Capital shortfall of regulated non-bank subsidiaries | 0 | | |
| 26f | Capital investment in a connected company which is a commercial entity (amount above 15% of the reporting institution's capital base) | 0 | | |
| 27 | Regulatory deductions applied to CET1 capital due to insufficient AT1 capital and Tier 2 capital to cover deductions | 0 | | |
| 28 | **Total regulatory deductions to CET1 capital** | **11,700** | | |
| 29 | **CET1 capital** | **29,400** | | |
| | **AT1 capital: instruments** | | | |
| 30 | Qualifying AT1 capital instruments plus any related share premium | 10,500 | | |
| 31 | of which: classified as equity under applicable accounting standards | 5,500 | | **(22) + (23)** |
| 32 | of which: classified as liabilities under applicable accounting standards | 5,000 | | **(16)** |
| 33 | *Capital instruments subject to phase out arrangements from AT1 capital* | 0 | | |
| 34 | AT1 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in AT1 capital of the consolidation group and eligible portion subject to phase out) | 290 | | **(26) + [(28) * 80%]** |
| 35 | *of which: AT1 capital instruments issued by subsidiaries subject to phase out arrangements* | 240 | | |
| 36 | **AT1 capital before regulatory deductions** | **10,790** | | |
| | **AT1 capital: regulatory deductions** | | | |
| 37 | Investments in own AT1 capital instruments | 0 | | |
| 38 | Reciprocal cross-holdings in AT1 capital instruments | 0 | | |
| 39 | Insignificant capital investments in AT1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation (amount above 10% threshold) | 0 | | |
| 40 | Significant capital investments in AT1 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | 0 | | |
| 41 | National specific regulatory adjustments applied to AT1 capital | 1,500 | | |
| 41a | Portion of deductions applied 50:50 to core capital and supplementary capital based on pre-Basel III treatment which, during transitional period, remain subject to deduction from Tier 1 capital | 1,500 | | |
| i | of which: Excess of total EL amount over total eligible provisions under the IRB approach | 100 | | **(29)** |
| ii | of which: Capital shortfall of regulated non-bank subsidiaries | 0 | | |
| iii | of which: Investments in own CET1 capital instruments | 0 | | |
| iv | of which: Reciprocal cross holdings in CET1 capital instruments issued by financial sector entities | 0 | | |
| v | of which: Capital investment in a connected company which is a commercial entity (amount above 15% of the reporting institution's capital base) | 0 | | |
| vi | of which: Insignificant capital investments in CET1 capital instruments, AT1 capital instruments and Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | 400 | | **(31)** |
| vii | of which: Significant capital investments in CET1 capital instruments, AT1 capital instruments and Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | 1,000 | | **(33)** |
| 42 | Regulatory deductions applied to AT1 capital due to insufficient Tier 2 capital to cover deductions | 0 | | |
| 43 | **Total regulatory deductions to AT1 capital** | **1,500** | | |
| 44 | **AT1 capital** | **9,290** | | |
| 45 | **Tier 1 capital (Tier 1 = CET1 + AT1)** | **38,690** | | |
| | **Tier 2 capital: instruments and provisions** | | | |
| 46 | Qualifying Tier 2 capital instruments plus any related share premium | 9,800 | | **(15)** |
| 47 | *Capital instruments subject to phase out arrangements from Tier 2 capital* | 0 | | |
| 48 | Tier 2 capital instruments issued by consolidated bank subsidiaries and held by third parties (amount allowed in Tier 2 capital of the consolidation group) | 50 | | **(27)** |
| 49 | *of which: capital instruments issued by subsidiaries subject to phase out arrangements* | 0 | | |
| 50 | Collective impairment allowances and regulatory reserve for general banking risks eligible for inclusion in Tier 2 capital | 500 | | **(12)** |
| 51 | **Tier 2 capital before regulatory deductions** | **10,350** | | |
| | **Tier 2 capital: regulatory deductions** | | | |

| | | | | |
|---|---|---|---|---|
| 52 | Investments in own Tier 2 capital instruments | 0 | | |
| 53 | Reciprocal cross-holdings in Tier 2 capital instruments | 0 | | |
| 54 | Insignificant capital investments in Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | 0 | | |
| 55 | Significant capital investments in Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | 0 | | |
| 56 | National specific regulatory adjustments applied to Tier 2 capital | 1,500 | | |
| 56a | Add back of cumulative fair value gains arising from the revaluation of land and buildings (own-use and investment properties) eligible for inclusion in Tier 2 capital | 0 | | |
| 56b | Portion of deductions applied 50:50 to core capital and supplementary capital based on pre-Basel III treatment which, during transitional period, remain subject to deduction from Tier 2 capital | 1,500 | | |
| i | of which: Excess of total EL amount over total eligible provisions under the IRB approach | 100 | | **(30)** |
| ii | of which: Capital shortfall of regulated non-bank subsidiaries | 0 | | |
| iii | of which: Investments in own CET1 capital instruments | 0 | | |
| iv | of which: Reciprocal cross holdings in CET1 capital instruments issued by financial sector entities | 0 | | |
| v | of which: Capital investment in a connected company which is a commercial entity (amount above 15% of the reporting institution's capital base) | 0 | | |
| vi | of which: Insignificant capital investments in CET1 capital instruments, AT1 capital instruments and Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | 400 | | **(32)** |
| vii | of which: Significant capital investments in CET1 capital instruments, AT1 capital instruments and Tier 2 capital instruments issued by financial sector entities that are outside the scope of regulatory consolidation | 1,000 | | **(34)** |
| 57 | **Total regulatory deductions to Tier 2 capital** | **1,500** | | |
| 58 | **Tier 2 capital** | **8,850** | | |
| 59 | **Total capital (Total capital = Tier 1 + Tier 2)** | **47,540** | | |

**Abbreviations:**

CET1: Common Equity Tier 1

AT1: Additional Tier 1

**Footnote:**

* Cross-referenced to Consolidated Balance Sheet in Step 2