

Q&As on IPO financing and Swap Connect

(Unless otherwise stated, references to Parts, Divisions, Subdivisions, Schedules, sections or formulas referred to in this document are to those of the Banking (Capital) Rules)

IPO financing

Q1. Under sections 64A(1) and 113A(1), one of the eligibility criteria for 0% risk-weight is that the money advanced by the institution under the facility is still legally owned and held by, and under the control of, the institution until the settlement of the payment for the securities successfully subscribed. Guidance is sought on the situations under which the money advanced is considered as legally owned and held by, and under the control of, the lending AI.

A1. The HKMA will consider that subsection (1)(c) of each of sections 64A and 113A has been met if—

- (a) the subscription application of the borrower financed by the loan is—
 - (i) made on behalf of the borrower in the name of a HKSCC participant that is the AI itself or its subsidiary; and
 - (ii) submitted to the HKSCC via FINI;
- (b) the cash for fulfilling the pre-funding requirement in respect of the subscription application is locked at a nominee bank account that is—
 - (i) set up by the AI in the capacity of the HKSCC participant's designated bank; and
 - (ii) in the name of the AI or a nominee company controlled by the AI;
- (c) the cash locked at the nominee bank account is legally owned by the AI; and
- (d) the AI's underwriting policies and risk controls with respect to the loan are consistent with the supervisory guidance on share margin financing issued or updated by the Monetary Authority from time to time.

To avoid doubt, IPO loans with either or both of the following arrangements will not be eligible for the risk-weight of 0%—

- the subscription application of the borrower financed by the AI is made on behalf of the borrower in the name of a HKSCC participant that is the AI's affiliate or a company (other than a subsidiary of the AI) within the same group to which the AI belongs;
- the money lent by the AI is held by another designated bank (regardless of whether such bank is within the same group to which the AI belongs).

Q2. During the IPO shares subscription cycle, there could be a short window of which an AI grants a facility to an IPO share subscriber but the loan is not yet drawn. What is the capital treatment of the facility during such window?

A2. Under sections 64A(2) and 113A(2), the 0% risk-weight is available starting from the time the commitment to extend the IPO loan is made by the AI. Hence, during such window, the AI has an off-balance sheet exposure arising from the commitment whose CCF is determined in accordance with Schedule 6. The 0% risk-weight treatment is also available to the concerned commitments under the IRB approach by virtue of section 202B.

Exposures to OCCPs in relation to Swap Connect

Q3. What is the capital treatment of participating margins posted by AIs for the purposes of the Swap Connect?

A3. Based on our discussion with the OTC Clearing Hong Kong Limited (“OTCC”)—

- (a) participating margins (“PMs”) posted by AIs that are OTCC’s clearing members (“CMs”) for the purposes of the Swap Connect will be treated in the same manner as default fund contributions under Division 4 of Part 6A of the Banking (Capital) Rules; and
- (b) the Shanghai Clearing House (“SHCH”) will be treated as if it were a CM of OTCC for the purpose of the calculation of the hypothetical capital (K_{ccp}) under Basel Framework CRE54.28 to CRE54.35¹.

1. Capital treatment of default fund contribution made by an AI to OTCC

An AI, *regardless of whether it has participated in the Swap Connect or not*, must calculate the capital charge for its default fund contribution made to OTCC in accordance with Formula 23K in section 226X(4) as set out below:

$$(a) K_{AI_{CMs}} = \max \left(K_{ccp(CM)} \cdot \left(\frac{DF_{AI}^{funded}}{DF_{CCP} + DF_{CM}^{funded}} \right); 8\% \cdot 2\% \cdot DF_{AI}^{funded} \right)$$

- (i) $K_{AI_{CMs}}$ is the capital charge for an AI’s usual default fund contribution (i.e. excluding PM in cases where the AI has participated in the Swap Connect);
- (ii) $K_{ccp(CM)}$ is the hypothetical capital for OTCC’s trade exposures to all its CMs (including those CMs that have participated in the Swap Connect). The value of $K_{ccp(CM)}$ will be provided by OTCC; and

¹ https://www.bis.org/basel_framework/chapter/CRE/54.htm?inforce=20230101&published=20200327

- (iii) DF_{CCP} , DF_{AI}^{funded} and DF_{CM}^{funded} are as defined in section 226X(4). Any additional collateral or resources contributed by OTCC, the AI and other CMs for the purposes of the Swap Connect must be excluded as they will be accounted for in the calculation discussed below.

2. Capital treatment of participating margin posted by an AI to OTCC for the AI's participation in the Swap Connect

If an AI has participated in the Swap Connect, the AI must, in addition to the capital charge for its usual default fund contribution calculated under paragraph 1, calculate a capital charge for its PM made to OTCC in accordance with Formula 23K in section 226X(4) as set out below:

$$(a) K_{AI_{SHCH}} = \max \left(K_{ccp(SHCH)} \cdot \left(\frac{PM_{AI}}{ICM_{OTCC} + ICM_{SHCH} + PM_{CM}} \right); 8\% \cdot 2\% \cdot PM_{AI} \right)$$

- (i) $K_{AI_{SHCH}}$ is the capital charge for an AI's PM;
- (ii) $K_{ccp(SHCH)}$ is the hypothetical capital for OTCC's trade exposures to SHCH;
- (iii) ICM_{OTCC} is OTCC's own resources contributed to the inter-CCP margin. For application of Formula 23K, ICM_{OTCC} will be treated as the DF_{CCP} defined in paragraph (c) of Formula 23K;
- (iv) ICM_{SHCH} is SHCH's half of the inter-CCP margin. For application of Formula 23K, this will be treated as part of the DF_{CM}^{funded} defined in paragraph (d) of Formula 23K;
- (v) PM_{AI} is the amount of PM contributed by the AI. For application of Formula 23K, this will be treated as the DF_{AI}^{funded} defined in paragraph (b) of Formula 23K; and
- (vi) PM_{CM} is the total amount of PMs contributed by OTCC's CMs. For application of Formula 23K, this will be treated as part of the DF_{CM}^{funded} defined in paragraph (d) of Formula 23K.
- (b) OTCC will disclose the value of a c-factor ("c") to enable AIs to calculate the capital charges for their PMs in accordance with paragraph (a), where—

$$c = \frac{K_{ccp(SHCH)}}{ICM_{OTCC} + ICM_{SHCH} + PM_{CM}}$$

- (c) As provided for under section 226Y(6A), OTCC may apply a 2% risk-weight to its trade exposure to SHCH in calculating $K_{ccp(SHCH)}$.

3. CAR return Part IIIe - reporting arrangement

Part IIIe: Risk-weighted Amount for Exposures to Central Counterparties (CCP)

(in HK\$'000)

Division A: Default Fund Contribution

	Default fund contribution (A1)	Capital Charge (A2)	Risk-weight % (A3)	Risk-weighted Amount (A4)
1. Qualifying CCPs				
2. Non-qualifying CCPs			1250	
SUBTOTAL				

An AI that is a CM of OTCC and has participated in the Swap Connect should report its default fund contribution and PM made to OTCC under item 1 in Division A of Part IIIe of the CAR return in the following manner—

(a) Item 1 - Column (A1) - Default fund contribution

The amount reported in respect of OTCC should be the sum of—

- DF_{AI}^{funded} (see paragraph 1(a)(iii) above); and
- PM_{AI} (see paragraph 2(a)(v) above).

(b) Item 1 - Column (A2) - Capital Charge

The amount reported in respect of OTCC should be the sum of—

- $K_{AI_{CMS}}$ (see paragraph 1(a)(i) above); and
- $K_{AI_{SHCH}}$ (see paragraph 2(a)(i) above).

(c) Item 1 - Column (A4) – Risk-weighted Amount

The AI should report the risk-weighted amount of its default fund contribution and PM made to OTCC in column (A4), which is calculated by multiplying the sum of the two capital charges reported in column (A2) by 12.5.