Completion Instructions

Return of Capital Adequacy Ratio
Part VI – Risk-weighted amount for Sovereign Concentration Risk
Form MA(BS)3(VI)

Introduction

1.   Form MA(BS)3(VI) should be completed by an authorized institution incorporated in Hong Kong to determine its risk-weighted amount for sovereign concentration risk for the calculation of capital adequacy ratios.

2.   This Form and its completion instructions should be read in conjunction with the Banking (Capital) Rules (BCR) and the relevant supervisory policy/guidance as applicable.

Section A: Definitions and General Instructions

3.   Unless otherwise stated, the institution shall refer to sections 2(1), 3 and 342 of the BCR for the interpretation of the terms used in this form and its completion instructions.

4.   In this return, "Credit protection provider" –
      (a) in relation to a collateral – means the issuer of the collateral;
      (b) in relation to a guarantee – means the guarantor under the guarantee; or
      (c) in relation to a credit derivative contract – means the protection seller under the contract.

5.   This part collects data on an institution's "concentrated sovereign exposure" to a country/jurisdiction. An AI has concentrated sovereign exposure to a country/jurisdiction if the aggregate amount of its specified sovereign exposure to all specified sovereign entities in that country/jurisdiction exceeds 100% of its Tier 1 capital. When determining whether this threshold is exceeded for a country/jurisdiction, an AI should use the amount of its Tier 1 capital as reported in Part I, Division A, item 1.1 of the Return of Capital Adequacy Ratio (i.e. Form MA(BS)(3)(I)) of the previous quarter if there has been no significant reduction in its Tier 1 capital during the reporting period. If there has been a reduction of 10% or more in its Tier 1 capital, the AI should use its most recent Tier 1 capital figure instead and inform its usual contact at the HKMA.

6.   "Specified sovereign exposure" is defined in section 342(1) of the BCR. In general, it covers direct exposure[1] to a specified sovereign entity and certain indirect exposure that arises from the specified sovereign entity acting as a credit protection provider for another exposure of the institution where the credit protection is in the form of collateral or guarantee and the specified sovereign entity is the collateral issuer or guarantor under

---

[1] Direct exposure refers to an exposure to a counterparty that is a direct obligator to an AI under a transaction or contract of the AI.

section 350(1) and (3)[2]. A specified sovereign exposure should be valued in accordance with Division 3, Part 10 of the BCR.

7. "Specified sovereign entity" is defined under section 342(1), which does not include the following:
   (a)   the Government;
   (b)   the Central People's Government of the People's Republic of China;
   (c)   the People's Bank of China;
   (d)   a sovereign foreign public sector entity of the Mainland of China;
   (e)   the Government of the United States of America.

8. The amount of concentrated sovereign exposure to a country/jurisdiction should be apportioned into amounts described in column 2 of Table 34 under section 344, to be multiplied by the corresponding risk-weights stated in column 3 of the same table for calculating the relevant risk-weighted amounts. The sum of these risk-weighted amounts is the risk-weighted amount of concentrated sovereign exposure to the country/jurisdiction.

Section B: Specific Instructions

9. Report in Column (2) of Item 1 under Part VI the country/jurisdiction code used in the Return of International Banking Statistics (MA(BS)21)[3] for any country/jurisdiction to which the institution has a concentrated sovereign exposure.

10. Report in Column (3) of Item 1 under Part VI the risk-weighted amount of the institution's concentrated sovereign exposure to the country/jurisdiction reported in Column (2) as calculated in accordance with section 344 of the BCR. See also para. 6 and Section C for an illustrative example of the calculation of risk-weighted amount for sovereign concentration risk.

Section C: Illustrative example of the calculation of risk-weighted amount for sovereign concentration risk

Suppose an authorized institution has the following exposures to Jurisdictions A, B and C:
(i)   Jurisdiction A: HK$2m sovereign bond and HK$1m placement to central bank;
(ii)   Jurisdiction B: HK$0.5m sovereign bond and HK$1m indirect exposure arising from a guarantee provided by the central government of Jurisdiction B which is not a recognized guarantee[4];
(iii) Jurisdiction C: HK$1.5m sovereign bond and HK$0.5m indirect exposure arising from the holding of a recognized collateral[5] issued by the central government of Jurisdiction C

---

[2] This should include any indirect exposure to a specified sovereign entity arising from a recognized collateral or recognized guarantee issued by the specified sovereign entity, which has been used to reduce a CRM covered exposure to a CRM uncovered portion of the exposure under rule 57(1) of the Banking (Exposure Limits) Rules (Cap. 155S), and valued at the amount so reduced.
[3] https://www.hkma.gov.hk/eng/key-functions/banking/banking-regulatory-and-supervisory-regime/regulatory-supervisory-framework/ma-bs-21/
[4] See rule 39(1) of the Banking (Exposure Limits) Rules for the definition of "recognized guarantee".
[5] See rule 39(1) of the Banking (Exposure Limits) Rules for the definition of "recognized collateral".

(as a result of the latter the AI has reduced the value of the exposure covered by this collateral by HK$0.5m in accordance with Division 6 of Part 7 of the Banking (Exposure Limits) Rules ("BELR")).

In addition, assume the institution had the following repo-style transactions with a counterparty (Counterparty X):

		AI delivered	AI received
(iv)	Reverse repo transaction	HK$1m cash	HK$1.2m Jurisdiction A sovereign bond (assume HK$1.14m after haircut)
(v)	Repo transaction	HK$0.5m Jurisdiction B sovereign bond in (ii) above* (assume HK$0.525m after haircut)	HK$0.5m cash
	Total (after haircut)	HK$1.525m	HK$1.64m

*It should be noted that the securities sold in a repo transaction (i.e. the Jurisdiction B sovereign bond in this case) is treated as an on balance sheet exposure of the institution as if the institution had never entered into the transaction and valued in accordance with section 349 of the BCR.

Through these repo-style transactions, the institution had gross default risk exposure of HK$1.525m (i.e. aggregate value of cash and securities delivered) to Counterparty X.

Case 1: No netting agreement with Counterparty X – Transactions (iv) and (v) have to be considered separately. Only transaction (iv) involves a collateral issued by a sovereign. Since the default risk exposure of HK$1m under transaction (iv) was fully offset by the Jurisdiction A sovereign bond, the institution should recognise a specified sovereign exposure of HK$1m to Jurisdiction A in the calculation of risk weighted amount of sovereign concentration risk to Jurisdiction A.

Case 2: Netting agreement applies to the transactions with Counterparty X – The aggregate gross default risk exposure amount of HK$1.525m in the netting set can be offset by the aggregate collateral received of HK$1.64m in the netting set. Again the full amount of exposure of HK$1.525m was offset by value of collateral available. For determining the amount of reduction attributable to individual collaterals in a basket of collateral, an AI should refer to rule 83 of the BELR. If, for example, an exposure is covered by a basket of collaterals and all the collaterals within the basket would result in the same risk-weighted amount of that exposure, the AI may pro-rata the amount of reduction by the value of individual collaterals. For example, in this case:
- Amount of reduction attributable to Jurisdiction A sovereign bond = HK$1.525 x (1.14/1.64) = HK$1.06m;
- Amount of reduction attributable to cash collateral = HK$1.525 x (0.5/1.64) = HK$0.465m.
- In this case, the institution should recognize a specified sovereign exposure of HK$1.06m to Jurisdiction A in the calculation of risk weighted amount of sovereign concentration risk to Jurisdiction A.

For the sake of convenience for illustration purpose, the AI's indirect exposure to Jurisdiction A arising from the repo-style transactions is assumed to be HK$1m. Taking this into account, the institution's exposure to Jurisdiction A becomes HK$4m.

The institution's Tier 1 capital reported in the last quarter was HK$0.6m.

The institution has concentrated sovereign exposure to Jurisdictions A and C because the amount of specified sovereign exposure to each of them exceeds the amount of the institution's Tier 1 capital. In relation to the institution's exposure to Jurisdiction B, specified sovereign exposure does not include the exposure arising from the guarantee provided by the central government of Jurisdiction B that is not a recognized guarantee. Accordingly, the institution's amount of specified sovereign exposure to Jurisdiction B (i.e. HK$0.5m) does not exceed its Tier 1 capital and therefore is not a concentrated sovereign exposure.

The risk-weighted amount for sovereign concentration risk of the institution would be calculated as follows:

Portion of concentrated sovereign exposure (% refers to % of the institution's Tier 1 capital)	Jurisdiction A		Jurisdiction C	
	Exposure amount (HK$'000)	Risk-weighted amount (HK$'000)	Exposure amount (HK$'000)	Risk-weighted amount (HK$'000)
Portion > 0% but ≤ 100% (Not applicable)	600	-	600	-
Portion > 100% but ≤ 150% (Risk-weight 5%)	300	15	300	15
Portion > 150% but ≤ 200% (Risk-weight 6%)	300	18	300	18
Portion > 200% but ≤ 250% (Risk-weight 9%)	300	27	300	27
Portion > 250% but ≤ 300% (Risk-weight 15%)	300	45	300	45
Portion > 300% (Risk-weight 30%)	2,200	660	200	60
Total risk-weighted amount for sovereign concentration risk*	**4,000**	**765 (Report under column 3, item 1)**	**2,000**	**165 (Report under column 3, item 1)**

* The total risk-weighted amount for sovereign concentration risk to all countries/jurisdictions of 930 (i.e. 765 + 165) in this example will be system-generated in item 2 of Part VI.

Hong Kong Monetary Authority
September 2022