Completion Instructions

Return of Capital Adequacy Ratio
Part II – Capital Base
Form MA(BS)3(II)

Introduction

1. Form MA(BS)3(II) should be completed by an authorized institution incorporated in Hong Kong to determine its capital base for the calculation of capital adequacy ratios ("CAR").

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

3. The institution shall refer to sections 2, 3 and 35 of the Capital Rules for the interpretation of the terms used in this form and its completion instructions.

4. The overall structure of the capital base calculation according to Part 3 of the Capital Rules is as follows –

Table A

	Components of Capital Base	**Reference to the Capital Rules**
(A1)	Elements of Common Equity Tier 1 (CET1) Capital	Sections 38(1) and (3)
(A2)	Deductions from CET1 Capital (including items excluded under section 38(2))	Sections 38(2) and 43 to 46
(A3)	**CET1 Capital = A1 – A2**	
(A4)	Elements of Additional Tier 1 (AT1) Capital	Section 39
(A5)	Deductions from AT1 Capital	Section 47
(A6)	**AT1 Capital = A4 – A5**	
(A7)	**Tier 1 (T1) Capital = A3 + A6**	Section 37
(A8)	Elements of Tier 2 (T2) Capital	Section 40
(A9)	Deductions from T2 Capital	Section 48
(A10)	**T2 Capital = A8 – A9**	
(A11)	**Total Capital = A7 + A10**	Section 36

Specific Instructions

Item	Nature of item
Part II(a)	**Capital Base**

5. For the purpose of calculating the institution's CAR, the capital base of the institution shall be the sum of the institution's Tier 1 capital (being the sum of the Common Equity Tier 1 ("CET1") capital and Additional Tier 1 capital) and Tier 2 capital, calculated in Hong Kong dollars after taking into account items excluded under section 38(2) and regulatory deductions specified in Part 3 Division 4 and subject to the *Transitional Arrangements in relation to Banking (Capital) (Amendment) Rules 2012* ("transitional arrangements") specified in Schedule 4H of the Capital Rules.

6. However, having considered its own circumstances, the institution may choose not to apply the transitional arrangements set out in Schedule 4H for a certain item or individual investment that is subject to deduction from CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires. Under that circumstance, the institution must inform the HKMA in writing of its decision, and must not change the decision thereafter without the prior consent of the HKMA.

7. The institution shall include in its CET1 capital, Additional Tier 1 capital or Tier 2 capital the proceeds of eligible instruments only to the extent that the instruments have been paid-up and are immediately available to the issuer of the instrument; or in the case of Additional Tier 1 or Tier 2 capital instruments are not issued out of an operating entity or any holding company of the institution, an operating entity or the holding company of the institution, as the case may be.

8. As outlined in paragraphs 59 and 86, if the institution has insufficient capital in a particular tier from which to make the required deductions, the remainder of the deduction amount (i.e. after bringing the net capital for that tier to zero) should be deducted from the next higher tier of capital. There are specific line items on the return to accommodate these transfers in deductions up the tiers.

Item	Nature of item
Category I	**Common Equity Tier 1 capital**[1]

(a) CET1 capital instruments

9. Report the institution's (in case it is a joint-stock company) paid-up ordinary share capital (including voting ordinary shares and ordinary shares ranking equally with voting ordinary shares in all respects except the absence of voting rights) that meets the *Qualifying Criteria to be Met to be CET1 Capital* ("CET1 Qualifying Criteria") set out in Schedule 4A of the Capital Rules **except** any shares issued by the institution by virtue of capitalizing any property revaluation reserves of the institution referred to in item (l) of Category III below.

10. Report the institution's (in case it is an entity other than a joint-stock company) capital instrument that is equivalent to ordinary shares in terms of loss absorption and meets the CET1 Qualifying Criteria set out in Schedule 4A.

(b) Share premium

11. Report the amount of the institution's share premium arising from the issue of CET1 capital instruments referred to in item (a) of Category I above.

(c) Retained earnings

12. Report in item (c) the amount of profits and losses of the institution brought forward pursuant to prevailing accounting standards as at a particular date which include the institution's –

    (i) unaudited profit or loss for the current financial year; and

    (ii) profit or loss of the immediately preceding financial year pending audit completion.

    The amount of profits and losses, if any, that has been related to sub-paragraphs (i) and (ii) above should be separately reported in item (c)(i).

(d) Disclosed reserves[2]

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1 Any capital instruments issued to third parties via a special purpose vehicle must not be included in an institution's CET1 capital.

2 Excluding the amount of retained earnings reported in item (c) above.

13. Report the institution's disclosed reserves in item (d). The amount of available-for-sale reserve that has been included in item (d) should be separately reported in item (d)(i).

(e) Minority interests arising from CET1 capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties

14. Where the MA requires under section 3C of the Capital Rules that the CAR of the institution is to be calculated on a ***consolidated basis*** in respect of the institution's bank subsidiaries, report in item (e) the applicable amount of minority interests, arising from the CET1 capital instruments issued by the consolidated bank subsidiaries of the institution (including retained earnings and reserves) and held by third parties, which is recognized as CET1 capital of the institution on a consolidated basis, as calculated in accordance with sections 2(1) and 3 of Schedule 4D (*Requirements to be Met for Minority Interests and Capital Instruments Issued by Consolidated Bank Subsidiaries and Held by Third Parties to be Included in Authorized Institution's Capital Base*) of the Capital Rules.

15. The maximum amount of minority interests in the bank subsidiary that can be included in the CET1 capital of the institution on a consolidated basis is calculated as:

$$\mathbf{A - (B * C)}$$

where:

A gross amount of total qualifying CET1 capital instruments of the bank subsidiary issued to third parties

B *(If the bank subsidiary is incorporated in Hong Kong)*

surplus CET1 capital of the subsidiary = CET1 capital of the bank subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 46 of the Capital Rules) less the lower of –

i. the sum of risk-weighted amount for credit risk, market risk and operational risk of the bank subsidiary, calculated on a solo basis or a solo-consolidated basis, as the case may be, multiplied by the percentage equal to the sum of –

(I) the minimum CET1 capital ratio that the bank subsidiary must comply with, on a solo basis or a solo-consolidated basis, as the case may be, under sections 3A and 3B of the

Capital Rules, and if applicable, as varied by the MA under section 97F of the Banking Ordinance (***"specified minimum ratio"***); and

(II) 2.5%, or

(Item i. corresponds to the minimum CET1 capital requirement of the bank subsidiary plus the capital conservation buffer of 2.5%)

ii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of –

(I) the minimum CET1 capital ratio that the institution must comply with on a consolidated basis, under sections 3A and 3B of the Capital Rules and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***"specified minimum ratio"***); and

(II) 2.5%.

(Item ii. corresponds to the portion, calculated as the consolidated minimum CET1 capital requirement plus the capital conservation buffer of 2.5%, that relates to the subsidiary)

Or

(If the bank subsidiary is not incorporated in Hong Kong)

surplus CET1 capital of the subsidiary = CET1 capital of the bank subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 46 of the Capital Rules) less –

iii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of –

(I) the minimum CET1 capital ratio that the institution must comply with on a consolidated basis, under sections 3A and

3B of the Capital Rules and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***"specified minimum ratio"***); and

(II) 2.5%.

(Item iii. corresponds to the portion, calculated as the consolidated minimum CET1 capital requirement plus the capital conservation buffer of 2.5%, that relates to the subsidiary)

Note:

An institution may choose to use **4.5%** (***"substitute percentage"***) instead of the ***specified minimum ratio*** referred to in items B.i.(I), B.ii.(I) and B.iii.(I) above.

C percentage of CET1 capital instruments of the bank subsidiary held by third parties

16. The calculation as shown above must be undertaken for each individual bank subsidiary separately. If the institution has chosen to use the ***substitute percentage***, it must not, without the MA's prior consent, use the ***specified minimum ratio*** subsequently. In addition, an institution must use only either the specified minimum ratio or the ***substitute percentage*** in respect of all of its bank subsidiaries that are members of its consolidation group.

17. **Annex II-A** is an illustrative example on how to calculate the applicable amount of minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties to be included in an institution's capital base.

18. If a minority interest or a capital instrument issued by a subsidiary of the institution (that is subject to a section 3C requirement and held by third parties) is no longer eligible for inclusion in the institution's capital base on 1 January 2013 but was included in the calculation of the institution's core capital and supplementary capital before that date, such minority interest or capital instrument must be progressively excluded from the capital base of the institution in accordance with the transitional arrangements specified in Table D of Schedule 4H of the Capital Rules. Any such amount is required to be reported in item (h)(i) or (k)(i) below as the case requires. Please refer to the illustrative examples in **Annex II-B** on how to calculate the exclusion of non-eligible minority interests or capital instruments held by third parties from an institution's capital base under different scenarios.

<u>CET1 Capital Before Deductions (A)</u>

19. This is the sum of items (a) to (e) in Column 2.

Regulatory deductions from CET1 Capital

20. The institution must exclude/deduct the following items from its CET1 capital and if applicable (please refer to the summary table below), in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H of the Capital Rules.

Item (f)	**Exclude/Deduct from CET1 in full beginning from 2013**	**Exclude/Deduct in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H**
(i) to (v)	Yes	
(vi)	Yes (except MSRs)	Only applicable for MSRs
(vii)		Yes
(viii)	Yes	
(ix) to (xi)	Yes	
(xii) & (xiii)		Yes
(xiv)	Yes	
(xv) to (xxi)		Yes

With respect to the regulatory deduction of an institution's capital investments in financial sector entities and commercial entities, **<u>Annex II-C</u>** provides an illustration showing the relevant components of different types of capital investments and loans, facilities or credit exposures that are required to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital under the Capital Rules.

(f)(i) <u>Cumulative cash flow hedge reserves that relate to the hedging of financial instruments that are not fair valued on the balance sheet</u>

21. Report the amount of cumulative cash flow hedge reserves that relates to the hedging of financial instruments that are not fair valued on the balance sheet (including projected cash flows) in this item. **Net fair value losses on revaluation of cash flow hedge should be added back to the institution's CET1 capital and reported in item (f)(i) with a <u>negative</u> sign.**

(f)(ii) <u>Cumulative fair value gains or losses on liabilities of the institution that are fair-valued and result from changes in the institution's own credit risk</u>

22. Report the amount of cumulative fair value gains or losses on liabilities of the institution that are fair-valued and result from changes in the institution's own credit risk except any debit

valuation adjustments for derivative contracts arising from the institution's own credit risk referred to in item (f)(xii). **Net fair value losses on revaluation of liabilities arising from changes in the institution's own credit risk should be added back to the institution's CET1 capital and reported in item (f)(ii) with a <u>negative</u> sign.**

(f)(iii) <u>Cumulative fair value gains arising from the revaluation of land and buildings</u>

23. Report the amount of –

(i) cumulative fair value gains arising from the revaluation of the institution's holdings of land and buildings (whether for the institution's own use or for investment purposes); and

(ii) cumulative fair value gains generated from any transaction or arrangement entered into between the institution and another member of the institution's consolidation group involving the disposal of land and buildings (whether for the institution's own use or for investment purposes) that are held by the institution, or that other member, unless otherwise approved by the MA.

For the avoidance of doubt, such gains whether net or gross of deferred tax liability should be based on the prevailing accounting standards applicable within a given jurisdiction.

(f)(iv) <u>Regulatory reserve for general banking risks</u>

24. Report the institution's regulatory reserve for general banking risks (either by earmarking approach or appropriation approach) referred to in section 40(1)(f) of the Capital Rules.

(f)(v) <u>Goodwill</u>

25. Report the amount of any goodwill that is recognized by the institution as an intangible asset of the institution, net of any associated deferred tax liabilities.

(f)(vi) <u>Other Intangible Assets</u>

26. Report the amount of other intangible assets (including mortgage servicing rights) of the institution, net of any associated deferred tax liabilities. The amount of mortgage servicing rights that has been included in this item should be separately reported under item (f)(vi)(1).

(f)(vii) <u>Defined benefit pension fund assets</u>

27. Report the assets of any defined benefit pension fund or plan (except those of such assets to which the institution can demonstrate to the satisfaction of the MA that it has unrestricted and unfettered access), net of the amount of obligations under the fund or plan and any associated deferred tax liabilities.

(f)(viii) Deferred tax assets in excess of deferred tax liabilities

28. Report the amount of deferred tax assets, net of deferred tax liabilities (excluding those associated with and already net against the deduction of the amount of goodwill, other intangible assets and assets of any defined benefit pension fund or plan) of the institution.

29. Deferred tax assets may be netted with deferred tax liabilities only if the deferred tax assets and deferred tax liabilities relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority.

(f)(ix) Gain-on-sale arising from securitization transactions

30. Report the amount of any gain-on-sale resulting from securitization transactions (whether held in the banking book or trading book) in which the institution is the originating institution.

31. The amount to be reported in item (f)(ix) of Part II(a) should be consistent with the sum of the figures reported in item B.1 under "Total amount" column of Division I of Form MA(BS)3(IIId) and item B.1 under "Total" column of Division A.1(b) of Form MA(BS)3(IV).

(f)(x) Securitization exposures specified in a notice given by the MA

32. Report the amount of any securitization exposure of the institution (whether held in the banking book or trading book) that the MA may, by notice in writing given to the institution, require the institution to deduct from its CET1 capital.

33. The amount to be reported in item (f)(x) of Part II(a) should be consistent with the sum of the figures reported in item B.2 under "Total amount" column of Division I of Form MA(BS)3(IIId) and item B.2 under "Total" column of Division A.1(b) of Form MA(BS)3(IV).

(f)(xi) Valuation adjustments

34. Where the application of paragraph 4.5 of the SPM module on "Financial Instrument Fair Value Practices" (CA-S-10) has led

to a lower carrying value than actually recognized under the current financial reporting standards as a result of valuation adjustments made, the absolute value of the difference should be reported in item (f)(xi) except:

(i) if that exposure is a financial instrument that gives rise to the cash flow hedge reserves that fall within item (f)(i) above; and

(ii) such part of the absolute value that have been taken into account in the calculation of the amount of the institution's retained earnings or other disclosed reserves (or part of the retained earnings or other disclosed reserves) that fall within items (c) and (d) above.

(f)(xii) Debit valuation adjustments (DVAs) in respect of derivative contracts

35. Report the amount of any DVAs made by the institution in respect of derivative contracts arising from the institution's own credit risk (which must not be offset by any accounting valuation adjustments arising from the institution's counterparty credit risk).

(f)(xiii) Excess of *total EL amount* over *total eligible provisions* under the IRB Approach

36. For an institution that adopts the IRB approach for its credit risk, if its total EL amount exceeds its total eligible provisions, it must deduct the excess amount of total EL amount over total eligible provisions from the institution's CET1 capital in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H of the Capital Rules. That is, where the institution applies the specified transitional arrangements, the amount to be reported in item (f)(xiii) should be not less than the amount derived by multiplying the figure reported in item 6 of Division F of Form MA(BS)3(IIIc) by the percentage shown in the column "Amount to be deducted from CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires, expressed in percentage points" in Table C of Schedule 4H of the Capital Rules that is applicable to the institution as at reporting date.

(f)(xiv) Cumulative losses below depreciated cost arising from the institution's holdings of land and buildings

37. Report any cumulative losses[3] of the institution arising from the institution's holdings of land and buildings below the depreciated cost value (whether or not any such land and buildings are held for the institution's own-use or for investment purposes) referred to in section 41(4) of the Capital Rules.

(f)(xv) <u>Capital shortfall of regulated non-bank subsidiaries</u>

38. Report the amount of any relevant capital shortfall as specified in a notice under section 45(1)(b) given to the institution in respect of a subsidiary of the institution that is a securities firm or insurance firm.

39. The capital shortfall amount to be reported in item (f)(xv) is in addition to any other deductions the institution is required to make above, as applicable, from its CET1 capital in respect of the subsidiary concerned of the institution; and represents the amount by which that subsidiary is deficient in meeting its minimum capital requirements.

40. For the avoidance of doubt, the institution's investment in any of its subsidiary securities and/or insurance firms which are subject to deductions above, as applicable, should be net of any goodwill relating to such investment in subsidiary securities and/or insurance firms which is already deducted from CET1 capital and reported in item (f)(v) above.

(f)(xvi) <u>Investments in own CET1 capital instruments</u>

41. Report the amount of any direct, indirect and synthetic holdings by the institution of its own CET1 capital instruments, unless already derecognized under applicable accounting standards, calculated in accordance with Schedule 4E of the Capital Rules. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (f)(xvi) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the Capital Rules; and

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[3] The "cumulative losses" here refer to the losses represented by any negative difference between the fair value and the depreciated cost value of the institution's properties (the latter is calculated as the cost of the building minus its accumulated depreciation, if any). To the extent that any amount of such "cumulative losses" has not been recognised as "impairment loss" through profit and loss account, the amount will need to be deducted from CET1 capital.

(iii) include in the amount to be deducted under item (f)(xvi) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

(f)(xvii) Reciprocal cross holdings in CET1 capital instruments

42. Report the amount of any direct, indirect and synthetic holdings by the institution of CET1 capital instruments issued by any financial sector entities where that entity has a reciprocal cross holding with the institution. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (f)(xvii) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the Capital Rules; and

(iii) include in the amount to be deducted under item (f)(xvii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

(f)(xviii) Capital investment in a connected company which is a commercial entity (f)(xviii)(1) Loans, facilities or other credit exposures that is required by section 46(1) of Capital Rules to be aggregated with item (f)(xviii)

43. Report in item (f)(xviii) the amount of the sum of the following to the extent that such sum is in excess of 15% of the capital base of the institution as reported in its capital adequacy ratio return as at the immediately preceding calendar quarter end date:

(i) the net book value of any capital investment in a connected company of the institution where that connected company is a commercial entity; and

(ii) any loans, facilities or other credit exposures provided by the institution to any connected company of the institution where the connected company is a commercial entity as if such loans, facilities or other credit exposures were direct capital investment by the institution in the commercial entity, except where the institution demonstrates to the satisfaction of the MA that any such loan was made, facility granted or other credit exposure incurred in the ordinary course of business.

44. Report separately in item (f)(xviii)(1) the amount of any loans, facilities or other credit exposures described in paragraph 43(ii) above that is included in the amount reported in item (f)(xviii).

(f)(xix) Insignificant capital investments in CET1 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement

(f)(xix)(1) Loans, facilities or other credit exposures that is required by section 46(2) of Capital Rules to be aggregated with item (f)(xix)

45. Subject to paragraphs 46 and 47, report in item (f)(xix) the sum of the applicable amounts of the following:

(i) the amount of direct , indirect and synthetic holdings of CET1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4F of the Capital Rules, if – (a) the entities are not the subject of consolidation under a section 3C requirement; (b) the holdings are insignificant capital investments; and (c) the holdings do not otherwise fall within items (f)(xvi) and (f)(xvii) above; and

(ii) any loans, facilities or other credit exposures provided by the institution to any connected companies of the institution where the connected company is a financial sector entity, except where the institution demonstrates to the satisfaction of the MA that any such loan was made, facility was granted or any such other credit exposure was incurred in the ordinary course of the institution's business.

46. For the purposes of paragraph 45(i), the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (f)(xix) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the Capital Rules; and

(iii) include in the amount to be deducted under item (f)(xix) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

47. For the purpose of determining the applicable amount to be deducted from the institution's CET1 capital under paragraph 45 above, such amount must be calculated by:

(D – E) * F

where:

D gross amount of the institution's aggregate holdings of insignificant capital instruments issued by and credit exposures to financial sector entities, as described in paragraph 45(i) and (ii) above

E 10% of the institution's CET1 capital, calculated after applying -

i. all deductions set out under items (f)(i) to (f)(xvii); and
ii. the portion of 50:50 deduction under transitional arrangements set out in Schedule 4H of the Capital Rules where such deduction is applied to CET1

capital due to insufficient Additional Tier 1 capital to cover the required deductions reported in item (f)(xxii) under paragraph 59 below

F percentage of the institution's gross holdings of CET1 capital investments over the institution's aggregate gross holdings of insignificant capital investments

Annex II-D is an illustrative example on how to calculate the applicable amount of insignificant and significant capital investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

48. Report separately in item (f)(xix)(1) the amount of any loans, facilities or other credit exposures described in paragraph 45(ii) above that is included in the amount reported in item (f)(xix).

49. The amount of insignificant capital investments issued by financial sector entities that do not exceed the 10% threshold referred to in paragraph 47 (i.e. E) and that are not deducted from an institution's CET1 capital is to continue to be risk-weighted in accordance with the applicable risk-weight under Part 4, 5, 6 or 8 of the Capital Rules, as the case requires.

(f)(xx) Significant capital investments in CET1 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement

(f)(xx)(1) Loans, facilities or other credit exposures provided that is required by section 46(2) of Capital Rules to be aggregated with item (f)(xx)

50. Subject to paragraphs 51 and 52, report in item (f)(xx) the sum of the applicable amounts of the following:

(i) the amount of the institution's direct, indirect and synthetic holdings of CET1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4G, if – (a) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution; (b) the holdings are significant capital investments; and (c) the holdings do not otherwise fall within items (f)(xvi) and (f)(xvii) above; and

(ii) any loans, facilities or other credit exposures provided by the institution to any connected company of the institution where the connected company is a financial sector entity, except where the institution demonstrates to the satisfaction of the MA that any such loan was made, facility was granted, or any such other credit exposure was incurred, in the ordinary course of the institution's business.

51. For the purposes of paragraph 50(i), the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (f)(xx) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the Capital Rules; and

(iii) include in the amount to be deducted under item (f)(xx) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

52. For the purpose of determining the applicable amount of an institution's significant CET1 capital instruments issued by financial sector entities referred to in paragraph 50 above, such amount must be calculated by:

(G – H)

where:

G gross amount of the institution's significant capital investments in CET1 capital instruments issued by and credit exposures to financial sector entities, as described in paragraphs 50(i) and (ii) above

H 10% of the institution's CET1 capital, calculated after applying -

i. all deductions under items (f)(i) to (f)(xix), (f)(xxi); and
ii. the portion of 50:50 deduction under transitional arrangements set out in Schedule 4H of the Capital Rules where such deduction is applied to CET1 capital due to insufficient Additional Tier 1 capital to cover the required deductions reported in item

(f)(xxii) under paragraph 59 below

<u>Annex II-D</u> is an illustrative example on how to calculate the applicable amount of insignificant and significant capital investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

53. Report separately in item (f)(xx)(1) the amount of any loans, facilities or other credit exposures described in paragraph 50(ii) above that is included in the amount reported in item (f)(xx).

54. The amount of an authorized institution's significant capital investment in CET1 capital instruments of a financial sector entity that does not exceed the 10% threshold referred to in paragraph 52 above and that is not deducted from its CET1 capital must be risk-weighted at 250%.

(f)(xxi) <u>Direct holdings of CET1 capital instruments issued by financial entities that are members of the institution's consolidation group</u>

(f)(xxi)(1) <u>Loans, facilities or other credit exposures that is required by section 46(2) of Capital Rules to be aggregated with item (f)(xxi)</u>

55. Items (f)(xxi) and (f)(xxi)(1) are applicable only for institution who calculates its CAR on a solo/solo-consolidated basis under a section 3C requirement.

56. Subject to paragraph 57, report in item (f)(xxi) the sum of the applicable amounts of the following:

(i) the institution's direct holdings of CET1 capital instruments issued by financial sector entities that are members of the institution's consolidation group; and

(ii) any loans, facilities or other credit exposures provided by the institution to any connected companies of the institution where the connected company is a financial sector entity, except where the institution demonstrates to the satisfaction of the MA that any such loan was made, facility granted or other credit exposure incurred in the ordinary course of the institution's business.

57. For the purposes of paragraph 56(i) above, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (f)(xxi) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section

43(1)(a) of the Capital Rules; and

(iii) include in the amount to be deducted under item (f)(xxi) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

58. Report separately in item (f)(xxi)(1) the amount of any loans, facilities or other credit exposures described in paragraph 56(ii) above that is included in the amount reported in item (f)(xxi).

(f)(xxii) Regulatory deductions applied to CET1 capital due to insufficient Additional Tier 1 capital to cover the required deductions

59. The institution should deduct from its CET1 capital the amount required to be deducted from Additional Tier 1 capital by virtue of section 47 and the transitional 50:50 deductions set out in Schedule 4H of the Capital Rules that exceeds the Additional Tier 1 capital of the institution.

60. If the institution's Additional Tier 1 capital before deductions **(C)** is less than the sum of deduction items (i)(i) to (i)(vii), then:

- report "0" in Additional Tier 1 capital after deductions **(D)**; and

- report the sum of items (i)(i) to (i)(vii) minus Additional Tier 1 capital before deductions **(C)** in item (f)(xxii).

CET1 Capital After Deductions **(B)**

61. This is the sum of items (a) to (e) in Column 2 after making the deductions specifically required from CET1 capital (i.e. items (f)(i) to (f)(xxii)).

62. This is also the figure to be reported in item 1.1(i) of Division A of Form MA(BS)3(I).

Category II **Additional Tier 1 capital**

(g) Additional Tier 1 capital instruments issued and share premium

(g)(i) Amount of capital instruments reported in item (g) that is subject to phase out

63. Report in item (g) the amount of:

    (i) the institution's capital instruments that meet the *Qualifying Criteria to be Met to be Additional Tier 1 Capital* ("AT1 Qualifying Criteria") set out in Schedule 4B of the Capital Rules;

    (ii) the amount of the institution's share premium arising from the issue of capital instruments referred to in sub-paragraph (i) above; and

    (iii) the amount of capital instruments no longer qualified for inclusion in capital base after 1 January 2013 but eligible to be phased out from that date.

64. With respect to paragraph 63(iii) above, the capital instruments of the institution that were included in the institution's capital base immediately before 1 January 2013 but do not meet all the AT1 Qualifying Criteria set out in Schedule 4B must be phased out during the 10-year transition period beginning from that date. Report separately in item (g)(i) the amount of capital instruments issued before 1 January 2013 which are eligible to be phased out based on the transitional arrangements set out in **Annex II-E**.

    Annex II-F contains an illustration for determining the extent of recognition of capital instruments as regulatory capital during the phase out period.

65. Additional Tier 1 capital instruments issued to third parties by the institution through a special purpose vehicle may be included in the Additional Tier 1 capital of the institution on a consolidated basis as if the institution itself had issued the capital instruments directly to third parties, provided that:

    (i) the special purpose vehicle is consolidated with the authorized institution;

    (ii) the capital instruments meet the AT1 Qualifying Criteria set out in Schedule 4B of the Capital Rules; and

    (iii) the only asset of the special purpose vehicle is its investment in the capital of the institution in a form that meets the AT1 Qualifying Criteria set out in Schedule 4B of the Capital Rules[4].

(h) Applicable amount of capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties

(h)(i) Amount of minority interests recognized in core capital under pre-amended Capital Rules reported in item (h) that is subject to phase out

66. Where the MA requires under section 3C of the Capital Rules that the CAR of the institution is to be calculated on a ***consolidated basis*** in respect of the institution's bank subsidiaries, report in item (h) the applicable amount of capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties, which is recognized as Additional Tier 1 capital of the institution on a consolidated basis, and calculated in accordance with sections 2(2) and 4 of Schedule 4D (*Requirements to be Met for Minority Interests and Capital Instruments Issued by Consolidated Bank Subsidiaries and held by Third Parties to be included in Authroized Institution's Capital Base*) of the Capital Rules together with the amount of minority interests eligible to be phased out from 1 January 2013 that were recognized in core capital of the institution under pre-amended Banking (Capital) Rules ("pre-amended Capital Rules") referred to in paragraph 71 below.

67. The maximum amount of Tier 1 capital instruments (i.e. CET1 capital instruments and Additional Tier 1 capital instruments) issued by the bank subsidiary to third parties that can be included in the Tier 1 capital of the institution on a consolidated basis is calculated as:

$$\mathbf{A - (B * C)}$$

where:

A gross amount of total qualifying Tier 1 capital instruments of the bank subsidiary issued to third parties

B *(If the bank subsidiary is incorporated in Hong Kong)*

surplus Tier 1 capital of the bank subsidiary = Tier 1 capital of the bank subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 47 of the Capital Rules) less the lower of

i. the sum of risk-weighted amount for credit risk, market risk and operational risk of the bank

[4] Assets that relate to the operation of the SPV may be excluded from this assessment if they are de minimis.

subsidiary, calculated on a solo basis or a solo-consolidated basis, as the case may be, and multiplied by the percentage equal to the sum of–

(I) the minimum Tier 1 capital ratio that the bank subsidiary must comply with, on a solo basis or a solo-consolidated basis, as the case may be, under sections 3A and 3B of the Capital Rules, and if applicable, as varied by the MA under section 97F of the Banking Ordinance (***"specified minimum ratio"***); and

(II) 2.5%, or

(Item i. corresponds to the minimum Tier 1 capital requirement of the bank subsidiary plus the capital conservation buffer of 2.5%)

ii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of–

(I) the minimum Tier 1 capital ratio that the institution must comply with, on a consolidated basis, under sections 3A and 3B of the Capital Rules and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***"specified minimum ratio"***); and

(II) 2.5%.

(Item ii. corresponds to the portion, calculated as the consolidated minimum Tier 1 capital requirement plus the capital conservation buffer of 2.5%, that relates to the subsidiary)

Or

(If the bank subsidiary is not incorporated in Hong Kong)

surplus Tier 1 capital of the bank subsidiary = Tier 1 capital of the bank subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 47 of the Capital Rules) less –

iii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of –

(I) the minimum Tier 1 capital ratio that the institution must comply with, on a consolidated basis, under sections 3A and 3B of the Capital Rules and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***"specified minimum ratio"***); and

(II) 2.5%.

(Item iii. corresponds to the portion, calculated as the consolidated minimum Tier 1 capital requirement plus the capital conservation buffer of 2.5%, that relates to the subsidiary)

Note:

An institution may choose to use **6%** (***"substitute percentage"***) instead of the ***specified minimum ratio*** referred to in items B.i.(I), B.ii.(I) and B.iii.(I) above.

C percentage of Tier 1 capital instruments of the bank subsidiary held by third parties

68. The amount of Tier 1 capital recognized in the Additional Tier 1 capital of an authorized institution on a consolidated basis must exclude the portion that has been recognized in the consolidated CET1 capital under paragraph 14 above.

69. The calculation as shown above must be undertaken for each individual bank subsidiary separately. If the institution has chosen to use the ***substitute percentage***, it must not, without the MA's prior consent, use the specified minimum ratio subsequently. In addition, the institution must use only either the ***specified minimum*** ratio or the substitute percentage in respect of all of its bank subsidiaries that are members of its consolidation group.

70. **Annex II-A** is an illustrative example on how to calculate the applicable amount of minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties to be included in authorized institution's capital base.

71. If a minority interest or a capital instrument issued by a subsidiary of the institution (that is subject to a section 3C requirement and held by third parties) is no longer eligible for inclusion in the institution's capital base on 1 January 2013 but was included in the calculation of the institution's core capital before that date, such minority interests or capital instrument must be progressively excluded from the capital

base of the institution in accordance with section 4 of Schedule 4H of the Capital Rules. Report separately in item (h)(i) any such minority interests or capital instruments that are included in the amount reported in item (h) .

72. If the institution issues capital instrument to third parties through a special purpose vehicle via a consolidated bank subsidiary of the institution and -

(i) the special purpose vehicle is consolidated with the bank subsidiary;

(ii) the capital instruments meet the AT1 Qualifying Criteria set out in Schedule 4B of the Capital Rules; and

(iii) the only asset of the special purpose vehicle is its investment in the capital of the bank subsidiary in a form that meets the AT1 Qualifying Criteria set out in Schedule 4B of the Rules[5],

the institution may treat the capital institutions as if the bank subsidiary itself had issued the capital instrument directly to the third parties, and may include the capital instruments in determining the applicable amount of the capital instruments to be included in the Additional Tier 1 capital of the institution on a consolidated basis as stipulated in paragraph 66 above.

<u>Additional Tier 1 Capital Before Deductions (C)</u>

73. This is the sum of items (g) and (h) in Column 2.

Regulatory deductions from Additional Tier 1 Capital

74. The institution must deduct the following items from its Additional Tier 1 capital in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H of the Capital Rules.

With respect to the regulatory deduction of an institution's capital investments in financial sector entities and commercial entities, **<u>Annex II-C</u>** provides an illustration showing the relevant components of different types of capital investments and loans, facilities or credit exposures that are required to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital under the Capital Rules.

[5] Assets that relate to the operation of the SPV may be excluded from this assessment if they are de minimis.

(i)(i) Investments in own Additional Tier 1 capital instruments

75. Report the amount of any direct, indirect and synthetic holdings by the institution of its own Additional Tier 1 capital instruments, unless already derecognized under applicable accounting standards, calculated in accordance with the provisions of Schedule 4E of the Capital Rules. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (i)(i) by any amount of goodwill (related to any holdings of Additional Tier 1 capital instruments falling within other items) already deducted under section 43(1)(a) of the Capital Rules; and

(iii) include in the amount to be deducted under item (i)(i) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

(i)(ii) Reciprocal cross holdings in Additional Tier 1 capital instruments

76. Report the amount of any direct, indirect and synthetic holdings by the institution of Additional Tier 1 capital instruments issued by financial sector entity where that entity has a reciprocal cross holding with the institution. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (i)(ii) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the Capital Rules; and

(iii) include in the amount to be deducted under item (i)(ii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

(i)(iii) Insignificant capital investments in Additional Tier 1 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement

77. Subject to paragraphs 78 below, report the applicable amount of the institution's direct, indirect and synthetic holdings of Additional Tier 1 capital instruments issued by financial sector entities, calculated in accordance with *Deduction of Holdings where Authorized Institution has Insignificant Capital Investments in Financial Sector Entities that are outside scope of Consolidation under Section 3C Requirement* ("deduction for insignificant capital investments") set out in Schedule 4F of the Capital Rules, if – (a) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution; (b) the holdings are insignificant capital investments; and (c) the holdings do not otherwise fall within items (i)(i) and (i)(ii) above. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (i)(iii) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the Capital Rules; and

(iii) include in the amount to be deducted under item (i)(iii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the

HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

78. For the purpose of determining the applicable amount to be deducted from the institution's Additional Tier 1 capital under paragraph 77 above, such amount must be calculated by:

(D – E) * F

where:

D gross amount of the institution's aggregate holdings of insignificant capital instruments issued by financial sector entities

E 10% of the institution's CET1 capital, calculated after applying -

i. all deductions under items (f)(i) to (f)(xvii); and
ii. the portion of 50:50 deduction under transitional arrangements set out in Schedule 4H of the Capital Rules where such deduction applied to CET1 capital due to insufficient Additional Tier 1 capital to cover the required deductions reported in item (f)(xxii) under paragraph 59 above

F percentage of the institution's gross holdings of Additional Tier 1 capital investments over the institution's aggregate gross holdings of insignificant capital investments

Annex II-D is an illustrative example on how to calculate the applicable amount of insignificant and significant investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

79. The amount of insignificant capital investments issued by financial sector entities that do not exceed the 10% threshold referred to in paragraph 78 above (i.e. E), and therefore not deducted from an institution's Additional Tier 1 capital, is to continue to be risk-weighted in accordance with the applicable risk-weight under Part 4, 5, 6 or 8 of the Capital Rules, as the case requires.

(i)(iv) Significant capital investments in Additional Tier 1 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement

80. Subject to paragraph 81 below, report the amount of the institution's direct, indirect and synthetic holdings of Additional Tier 1 capital instruments issued by financial sector entities, calculated in accordance with the provisions of Schedule 4G (*Deduction of Holdings where Authorized Institution has Significant Capital Investment in Financial Sector Entities that are outside Scope of Consolidation under Section 3C Requirement*) of the Capital Rules, if – (a) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution; (b) the holdings are significant capital investments; and (c) the holdings do not otherwise fall within items (i)(i) and (i)(ii) above. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (i)(iv) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the Capital Rules; and

(iii) include in the amount to be deducted under item (i)(iv) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

81. All significant capital investments in capital instruments issued by financial sector entities that are not in the form of CET1 capital instruments must be fully deducted from an authorized institution's Additional Tier 1 capital or Tier 2 capital, as the case requires, by reference to the tier of capital for which the capital instruments would qualify if they were issued by the

institution itself.

<u>Annex II-D</u> is an illustrative example on how to calculate the applicable amount of insignificant and significant investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

(i)(v) <u>Direct holdings of Additional Tier 1 capital instruments issued by financial entities that are members of the institution's consolidation group</u>

82. Item (i)(v) is applicable only for institution who calculates its CAR on a solo/solo-consolidated basis under a section 3C requirement.

83. Report the amount of the institution's direct holdings of Additional Tier 1 capital instruments issued by financial sector entities that are members of the institution's consolidation group. For this purpose, the institution must:

    (i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

    (ii) reduce the amount to be deducted under item (i)(v) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the Capital Rules; and

    (iii) include in the amount to be deducted under item (i)(v) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

(i)(vi) <u>50% of the total deductible amount applied to Tier 1 capital under transitional arrangements reported in Part II(b)</u>

84. If the institution is required to make a 50:50 deduction from its Tier 1 capital by virtue of transitional arrangements set out in section 3(5) of Schedule 4H of the Capital Rules, report in item

(i)(vi) 50% of the total deductible amount as reported in Part II(b).

85. For the purpose of this item, if the amount of the 50% of the total deductible amount required to be deducted from Tier 1 capital is greater than the amount of Additional Tier 1 capital, the amount of excess must be deducted from the institution's CET1 capital. Such amount is required to be reported in item (f)(xxii) in addition to any regulatory deductions applied to CET1 capital due to insufficient Additional Tier 1 capital to cover such deductions.

(i)(vii) Regulatory deductions applied to Additional Tier 1 capital due to insufficient Tier 2 capital to cover the required deductions

86. The institution is required to make from its Tier 2 capital any regulatory deductions by virtue of section 48 and the transitional 50:50 deductions set out in section 3(5) of Schedule 4H of the Capital Rules. Such deductions must be applied to Additional Tier 1 capital in case Tier 2 capital of the institution is not sufficient to cover the required deductions.

87. If the institution's Tier 2 capital before deductions **(F)** is less than the sum of deduction items (r)(i) to (r)(vi), then:

- report "0" in Tier 2 capital after deductions **(G)**; and

- report the sum of items (r)(i) to (r)(vi) minus Tier 2 capital before deductions **(F)** in item (i)(vii).

Additional Tier 1 Capital After Deductions **(D)**

88. This is the sum of items (g) and (h) in Column 2 after making the deductions specifically required from Additional Tier 1 capital (i.e. items (i)(i) to (i)(vii)). However, if an institution's Additional Tier 1 capital before deductions **(C)** is less than the sum of deduction items (i)(i) to (i)(vii), then report "0" in Additional Tier 1 capital deductions **(D)** and follows the instructions set out in paragraph 60.

89. This is also the figure to be reported in item 1.1(ii) of Division A of Form MA(BS)3(I).

Tier 1 Capital **(E)**

90. This is the sum of CET1 capital after deductions **(B)** and Additional Tier 1 capital after deductions **(D)**.

91. This is also the figure to be reported in item 1.1 of Division A of Form MA(BS)3(I).

Item Nature of item

Category III **Tier 2 Capital**

(j) Tier 2 capital instruments issued and share premium

(j)(i) Amount of capital instruments reported in item (j) that is subject to phase out arrangements

92. Report in item (j) the amount of:

(i) the institution's capital instruments that meet the Tier 2 Qualifying Criteria as specified in Schedule 4C of the Capital Rules;

(ii) the amount of the institution's share premium arising from the issue of capital instruments referred to in sub-paragraph (i) above; and

(iii) the amount of capital instruments no longer qualified for inclusion in capital base after 1 January 2013 but eligible to be phased out from that date.

93. With respect to paragraph 92(iii), the capital instruments of the institution that were included in the institution's capital base immediately before 1 January 2013 but that do not meet all the qualifying criteria set out in Schedule 4C must be phased out during the 10-year transition period beginning from that date. Report separately in item (j)(i) the amount of capital instruments issued before 1 January 2013 which are eligible to be phased out based on the transitional arrangements set out in **Annex II-E**.

Annex II-F contains an illustration for determining the extent of recognition of capital instruments as regulatory capital during the phase out period.

94. Tier 2 capital instruments issued to third parties by the institution through a special purpose vehicle may be included in the Tier 2 capital of the institution on a consolidated basis as if the institution itself had issued the capital instruments to third parties, provided that:

(i) the special purpose vehicle is consolidated with the authorized institution;

(ii) the capital instruments meet the qualifying criteria set out in Schedule 4C of the Capital Rules; and

(iii) the only asset of the special purpose vehicle is its investment in the capital of the institution in a form that meets the Tier 2 Qualifying Criteria set out in Schedule 4C of the Capital Rules[6].

(k) Applicable amount of capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties

(k)(i) Amount of minority interests recognized in supplementary capital under pre-amended Capital Rules reported in item (k) that is subject to phase out

95. Where the MA requires under section 3C of the Capital Rules that the CAR of the institution is to be calculated on a ***consolidated basis*** in respect of the institution's bank subsidiaries, report in item (k) the applicable amount of capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties, which is recognized as Tier 2 capital of the institution on a consolidated basis, and calculated in accordance with sections 2(2) and 5 of Schedule 4D (*Requirements to be Met for Minority Interests and Capital Instruments Issued by Consolidated Bank Subsidiaries and held by Third Parties to be included in Authorized Institution's Capital Base*) of the Capital Rules together with the phase out amount of minority interests eligible to be phased out from 1 January 2013 that were recognized in supplementary capital of the institution under pre-amended Capital Rules referred to in paragraph 100 below.

96. The maximum amount of all capital instruments (i.e. CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments) issued by the bank subsidiary to third parties that can be included in the Total capital of the institution on a consolidated basis is calculated as:

A – (B * C)

where:

A gross amount of total qualifying capital instruments of the bank subsidiary issued to third parties

B *(If the bank subsidiary is incorporated in Hong Kong)*

surplus Total capital of the subsidiary = Total capital of the subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 48 of the Capital Rules) less the lower of –

i. the sum of risk-weighted amount for credit risk, market risk and operational risk of the bank

6 Assets that relate to the operation of the SPV may be excluded from the assessment if they are de minimis.

subsidiary, calculated on a solo basis or a solo-consolidated basis, as the case may be, and multiply by the percentage equal to the sum of –

(I) the minimum Total capital ratio that the bank subsidiary must comply with, on a solo basis or a solo-consolidated basis, as the case may be, under sections 3A and 3B of the Capital Rules, and if applicable, as varied by the MA under section 97F of the Banking Ordinance (***"specified minimum ratio"***); and

(II) 2.5%, or

(Item i. corresponds to the minimum Total capital requirement of the bank subsidiary plus the capital conservation buffer of 2.5%)

ii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of –

(I) the minimum Total capital ratio that the institution must comply with on a consolidated basis, under sections 3A and 3B of the Capital Rules and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***"specified minimum ratio"***); and

(II) 2.5%.

(Item ii. corresponds to the portion, calculated as the consolidated minimum Total capital requirement plus the capital conservation buffer of 2.5% that relates to the subsidiary)

Or

(If the bank subsidiary is not incorporated in Hong Kong)

surplus Total capital of the subsidiary = Total capital of the subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 48 of the Capital Rules) less –

iii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of –

(I) the minimum Total capital ratio that the institution must comply with on a consolidated basis, under sections 3A and 3B of the Capital Rules and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***"specified minimum ratio"***); and

(II) 2.5%.

(Item iii. corresponds to the portion, calculated as the consolidated minimum Total capital requirement plus the capital conservation buffer of 2.5% that relates to the subsidiary)

Note:

An institution may choose to use **8%** (***"substitute percentage"***) instead of the ***specified minimum ratio*** referred to in items B.i.(I), B.ii.(I) and B.iii.(I) above.

C percentage of total capital instruments of the subsidiary held by third parties

97. The amount of Total capital recognized in the Tier 2 capital of an authorized institution on a consolidated basis must exclude the portion that has been recognized in the consolidated Tier 1 capital under paragraph 66 above.

98. The calculation as shown above must be undertaken for each individual bank subsidiary separately. If the institution has chosen to use the substitute percentage, it must not, without the MA's prior consent, use the specified minimum ratio subsequently. In addition, the institution must use only either the specified minimum ratio or the substitute percentage in respect of all the bank subsidiaries of the institution that are members of its consolidation group.

99. **Annex II-A** is an illustrative example on how to calculate the applicable amount of minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties to be included in authorized institution's capital base.

100. If a minority interest or a capital instrument issued by a subsidiary of the authorized institution (that is subject to a section 3C requirement and held by third parties) is no longer eligible for inclusion in the institution's capital base on 1 January 2013 but was included in the calculation of the institution's supplementary capital before that date, such minority interest or capital instrument must be progressively excluded from the capital base of the institution in accordance

with section 4 of Schedule 4H of the Capital Rules. Report separately in item (k)(i) any such minority interests or capital instruments that are included in the amount reported in item (k).

101. If the institution issues Tier 2 capital instrument to third parties through a special purpose vehicle via a consolidated bank subsidiary and -

(i) the special purpose vehicle is consolidated with the bank subsidiary;

(ii) the capital instruments meet the Tier 2 Qualifying Criteria set out in Schedule 4C of the Capital Rules; and

(iii) the only asset of the special purpose vehicle is its investment in the capital of the bank subsidiary in a form that meets the Tier 2 Qualifying Criteria set out in Schedule 4C of the Rules[7],

the institution may treat the capital institutions as if the bank subsidiary itself had issued the capital instrument directly to third parties, and may include the capital instruments in determining the applicable amount of the capital instruments to be included in the consolidated Additional Tier 1 capital of the institution as mentioned in paragraph 95 above.

(l) <u>Reserves attributable to fair value gains on revaluation of the institution's holdings of land and buildings[8]</u>

102. Subject to paragraphs 103, 104, 105 and 107, report in this item the institution's reserves and retained earnings that is attributable to fair value gains arising from:

(i) the revaluation of the institution's holdings of land and buildings except land and buildings mortgaged to the institution to secure a debt;

(ii) the revaluation of the institution's share of the net asset value of any subsidiary of the institution to the extent that the value has changed as a result of the revaluation of the subsidiary's holdings of land and buildings except any land and buildings mortgaged to the subsidiary to secure a debt; and

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[7] Assets that relate to the operation of the SPV may be excluded from the assessment if they are de minimis.

[8] According to sections 29, 30 and 31 of the Capital Rules, the institution is allowed to deduct the portion of reserves not recognized in Tier 2 capital (i.e. the amount of the 55% haircut) from the institution's total risk-weighted amount. Such deductible amount should be reported in item 2.12(ii) of Division A of Form MA(BS)3(I).

(iii) disposal of land and buildings (whether for the institution's own-use or for investment purposes) referred to in section 38(2)(d) of the Capital Rules.

Provided that:

(a) the institution has a clearly documented policy on the frequency and method of revaluation of its holdings of land and buildings that is satisfactory to the MA;

(b) the institution does not depart from that policy except after consultation with the MA;

(c) subject to sub-paragraph (d) below, any revaluation of the institution's holdings of land and buildings is undertaken by an independent professional valuer;

(d) in any case where the institution demonstrates to the satisfaction of the MA that, despite all reasonable efforts, it has been unable to obtain the services of an independent professional valuer to undertake the revaluation of all or part, as the case may be, of the institution's holdings of land and buildings, any revaluation of such holdings undertaken by a person who is not an independent professional valuer is endorsed in writing by an independent professional valuer;

(e) any revaluation of the institution's holdings of land and buildings is approved by the institution's external auditors of the institution and explicitly reported in the institution's audited accounts; and

(f) the fair value gains relating to paragraphs 102(i) to (iii) above are recognized in accordance with applicable accounting standards and any such gains not recognized in the financial statements of the institution are excluded.

103. The shares issued by the institution through capitalizing that part of the institution's reserves and retained earnings that is attributable to fair value gains described in paragraph 102 above is allowed to be added back in the institution's Tier 2 capital.

104. The amount of the fair value gains on revaluation of each of paragraphs 102(i) to (iii) above, which may be included in Tier 2 capital, shall not exceed 45% of each of such fair value gains (i.e. applying a haircut of 55% to each of such gains).

105. The institution must not, in calculating its Tier 2 capital, set-off losses in respect of the institution's own use land and buildings

where such losses are recognized in the institution's profit or loss against unrealized gains that are reflected directly in the institution's equity through the statement of changes in equity.

106. The institution must deduct from its CET1 capital any cumulative losses of the institution arising from the institution's holdings of land and buildings below the depreciated cost value (whether or not any such land and buildings are held for the institution's own-use or for investment purposes). Such amount, if any, is to be reported in item (f)(xiv) above.

107. For the purposes of item (l), reserves attributable to fair value gains on revaluation of the institution's holdings of land and buildings. Whether the amount should be net or gross of deferred tax liability should be based on the prevailing accounting standards applicable within a given jurisdiction.

(m), (n) & (o) Regulatory reserve for general banking risks and collective provisions[9]

108. For an institution which uses the STC approach or BSC approach, or both, to calculate its credit risk, report the institution's regulatory reserve for general banking risks in item (m) and collective provisions in item (n).

109. Subject to paragraphs 110 and 111 below, the institution adopting the STC approach or BSC approach, or both, must only include that amount of its total regulatory reserve for general banking risks and collective provisions in its Tier 2 capital up to a limit of 1.25% of its risk-weighted amount for credit risks (being the sum of all the institution's risk-weighted amounts for all of its non-securitization exposures to credit risk subject to the STC approach or BSC approach, or both; and all of its securitization exposures to credit risk subject to the STC(S) approach but excluding the risk-weighted amount for CCP and CVA, if any). Report the eligible amount to be included in the institution's Tier 2 capital in item (o).

110. For an institution which uses any combination of the STC approach, BSC approach and IRB approach –

(i) subject to sub-paragraph (ii) below, the institution must apportion its total regulatory reserve for general banking risks and collective provisions between the STC approach,

[9] According to sections 29, 30 and 31 of the Capital Rules, the institution is allowed to deduct the portion of its total regulatory reserve for general banking risks and collective provisions apportioned to the STC approach or BSC approach, or both, and STC(S) approach which is not included in Tier 2 capital from the institution's total risk-weighted amount. Such deductible amount should be reported in item 2.12(i) of Division A of Form MA(BS)3(I).

BSC approach, IRB approach, STC(S) approach and IRB(S) approach on a pro rata basis according to the proportions of the institution's risk-weighted amount for credit risk that are calculated by using the STC approach, BSC approach, IRB approach, STC(S) approach or IRB(S) approach (that is to say, the credit RWA should exclude risk-weighted amount for CCP and CVA, if any), as the case requires;

(ii) the institution may, with the prior consent of the MA, use its own method to apportion its total regulatory reserve for general banking risks and collective provisions as required in sub-paragraph (i) above; and

(iii) the institution must, after it has carried out the apportionment referred to in sub-paragraphs (i) and (ii) above –

(a) comply with paragraph 109 above in respect of that portion of its total regulatory reserve for general banking risks and collective provisions that is apportioned to the STC approach or BSC approach, or both, and the STC(S) approach; and

(b) subject to paragraphs 111 and 112 below, exclude from its Tier 2 capital (i.e. exclude from items (m), (n) and (o)) that portion of its total regulatory reserve for general banking risks and collective provisions which is apportioned to the IRB approach and IRB(S) approach.

(p) Surplus provisions (for exposures calculated by using IRB approach)

111. For the institution that adopts the IRB approach for credit risk, if its total EL amount is less than its total eligible provisions, the institution may include the amount of the excess of the total eligible provisions over the total EL amount (i.e. the surplus provisions) in its Tier 2 capital up to 0.6% of its risk-weighted amount for credit risk calculated by using the IRB approach (that is to say, the credit RWA should exclude risk-weighted amount for CCP and CVA, if any). The amount to be reported in item (p) of Part II(a) should be consistent with the figure reported in item 9 of Division F of Form MA(BS)3(IIIc).

(q) The portion of an AI's total regulatory reserve for general banking risks and collective provisions that is apportioned to the IRB(S) approach

112. For the institution adopting the IRB(S) approach, report in item (q) that portion of its total regulatory reserve for general banking risks and collective provisions that is apportioned to

the IRB(S) approach in accordance with paragraphs 110(i) or (ii) in its Tier 2 capital up to 0.6% of its risk-weighted amount for credit risk calculated by using the IRB(S) approach (that is to say, the credit RWA should exclude the risk-weighted amount for CCP and CVA, if any).

Tier 2 Capital Before Deductions (F)

113. This is the sum of items (j), (k), (l), (o), (p) and (q) in Column 2.

Regulatory deductions from Tier 2 Capital

114. The institution must deduct from its Tier 2 capital in accordance with the transitional arrangements set out in sections 2 and 3 of Schedule 4H of the Capital Rules.

With respect to the regulatory deduction of an institution's capital investments in financial sector entities and commercial entities, **Annex II-C** provides an illustration showing the relevant components of different types of capital investments and loans, facilities or credit exposures that are required to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital under the Capital Rules.

(r)(i) Investments in own Tier 2 capital instruments

115. Report the amount of any direct, indirect and synthetic holdings by the institution of its own Tier 2 capital instruments, unless already derecognized under applicable accounting standards, calculated in accordance with the requirements specified in Schedule 4E of the Rules. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(ii) include in the amount to be deducted under item (r)(i) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

(r)(ii) <u>Reciprocal cross holdings in Tier 2 capital instruments</u>

116. Report the amount of any direct, indirect and synthetic holdings by the institution of Tier 2 capital instruments issued by financial sector entity where that entity has a reciprocal cross holding with the institution. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(ii) include in the amount to be deducted under item (r)(ii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

(r)(iii) <u>Insignificant capital investments in Tier 2 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement</u>

117. Subject to paragraph 118 below, report the applicable amount of the institution's direct, indirect and synthetic holdings of Tier 2 capital instruments issued by financial sector entity, calculated in accordance with Schedule 4F of the Capital Rules, if – (a) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution; (b) the holdings are insignificant capital investments; and (c) the holdings do not otherwise fall within items (r)(i) and (r)(ii) above. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(ii) include in the amount to be deducted under item (r)(iii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

118. For the purpose of determining the applicable amount to be deducted from the institution's Tier 2 capital under paragraph 117 above, such amount must be calculated by:

(D – E) * F

where:

D gross amount of the institution's aggregate holdings of insignificant capital investments issued by financial sector entities

E 10% of the institution's CET1 capital, calculated after applying -

i. all deductions under items (f)(i) to (f)(xvii); and
ii. the portion of 50:50 deduction under transitional arrangements set out in Schedule 4H of the Capital Rules where such deduction applied to CET1 capital due to insufficient Additional Tier 1 capital to cover the required deductions reported in item (f)(xxii) under paragraph 59 above

F percentage of the institution's gross holdings of Tier 2 capital investments over the institution's aggregate gross holdings of insignificant capital investments

Annex II-D is an illustrative example on how to calculate the applicable amount of insignificant and significant investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

119. The amount of insignificant capital investments issued by financial sector entities that do not exceed the 10% threshold referred to in paragraph 118 above (i.e. E) and therefore not deducted from an institution's Tier 2 capital, is continue to be

risk-weighted in accordance with the applicable risk weight under Part 4, 5, 6 or 8 of the Capital Rules, as the case requires.

(r)(iv) <u>Significant capital investments in Tier 2 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement</u>

120. Subject to paragraph 121 below, report the amount of the institution's direct, indirect and synthetic holdings of Tier 2 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4G of the Capital Rules, if – (a) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution; (b) the holdings are significant capital investments; and (c) the holdings doe not otherwise fall within items (r)(i) and (r)(ii) above. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(ii) include in the amount to be deducted under item (r)(iv) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

121. All significant capital investments in capital instruments issued by financial sector entities that are not in the form of CET1 capital instruments must be fully deducted from an authorized institution's Additional Tier 1 capital and Tier 2 capital, as the case requires, by reference to the tier of capital for which the capital instruments would qualify if they were issued by the institution itself.

<u>Annex II-D</u> is an illustrative example on how to calculate the applicable amount of insignificant and significant investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

(r)(v) Direct holdings of Tier 2 capital instruments issued by financial sector entities that are members of the institution's consolidation group

122. Item (r)(v) is applicable only for institution who calculates its CAR on a solo/solo-consolidated basis under a section 3C requirement.

123. Report the amount of the institution's direct holdings of Tier 2 capital instruments issued by financial sector entities that are members of the institution's consolidation group. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(ii) include in the amount to be deducted under item (r)(v) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potent future holding.

(r)(vi) 50% of the total deductible amount applied to Tier 2 capital reported during the transition period reported in Part II(b)

124. If the institution is required to make a 50:50 deduction from its Tier 2 capital by virtue of transitional arrangements set out in section 3(5) of Schedule 4H of the Capital Rules, report in item (r)(vi) 50% of the total deductible amount as reported in Part II(b).

125. For the purpose of this item, if the amount of the 50% of the total deductible amount required to be deducted from Tier 2 capital is greater than the amount of Tier 2 capital, the amount of excess must be deducted from the institution's Tier 1 capital. Such amount is required to be reported in item (i)(vii) in addition to any regulatory deductions applied to Additional Tier 1 capital due to insufficient Tier 2 capital to cover such deductions.

Tier 2 Capital After Deductions **(G)**

126. This is the sum of items (j), (k), (l), (o) (p) and (q) in Column 2 after making the deductions specifically required from Tier 2 capital (i.e. items (r)(i) to (r)(vi)).

127. If the institution's Tier 2 capital before deductions **(F)** is less than the sum of deduction items (r)(i) to (r)(vi), then:

- report "0" in Tier 2 capital after deductions **(G)**; and

- report the sum of items (r)(i) to (r)(vi) minus Tier 2 capital before deductions **(F)** in item (i)(vii).

128. This is also the figure to be reported in item 1.2 of Division A of Form MA(BS)3(I).

Capital Base

Capital Base **(H)**

129. This is the aggregate of Tier 1 capital after deductions **(E)** and Tier 2 capital after deductions **(G)**.

130. This is also the figure to be reported in item 1.3 of Division A of Form MA(BS)3(I).

Item | Nature of item

Part II(b) **Breakdown of deductible items during transitional period**

131. The HKMA allowed a transitional period (from 1 January 2013 to 31 December 2017) for the phasing-in of those capital deductions which under the Capital Rules are required to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital but which were either deducted on an equal basis from core capital and supplementary capital or risk-weighted under the pre-amended Capital Rules before 1 January 2013. Section 3 of Schedule 4H of the Capital Rules set out such transitional arrangement [10] of capital deductions for determination of the institution's capital base.

132. This part collects a breakdown of items incurred before 1 January 2013[11] that are –

(i) ***transitioned*** (referring to the portion of those items that are already subject to deduction from an institution's CET1 capital, Additional Tier 1 capital and/or Tier 2 capital under the Capital Rules) during the transitional period; and

(ii) ***not yet transitioned*** (referring to the portion of those items that are subject to risk-weighting according to Part 4, 5, 6 or 8 of the Rules and/or transitional 50:50 deduction from the institution's Tier 1 capital and Tier 2 capital, as the case requires) during the transitional period,

to arrive at the capital base during the transitional period starting from 1 January 2013.

Annex II-G is an illustrative example on how to report this Form.

133. In respect of items that –

(i) were not deducted under sections 48(2)(c), (d), (e), (f) and (g) of the pre-amended Capital Rules, and were subject to the risk-weighting framework of those Rules, before 1 January 2013; but

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10 An authorized institution may, for any reasons, choose not to apply the transitional arrangements set out in Schedule 4H for a certain item or individual investment that is subject to deduction from CET1 capital, Additional Tier 1 capital or Tier 2 capital, as the case requires. The institution must inform the MA in writing of its decision and must not change its decision without the prior approval of the MA.

11 In other words, any new items incurred on or after 1 January 2013 (for example, new capital investments made on or after 1 January 2013) to which transitional arrangements are inapplicable should not be reported in Part II(b).

(ii) are subject to deduction under Division 4 of Part 3 of the Capital Rules on and after 1 January 2013,

report separately the portions of the amount of each individual item that are subject to –

(i) deduction from the institution's CET1 capital, Additional Tier 1 capital and/or Tier 2 capital in Column 1 ***(Amount transitioned)***; and

(ii) risk-weighting according to Part 4, 5, 6 or 8 of the Capital Rules but before applying relevant risk-weight in Column 2 ***(Risk-weight - Amount not yet transitioned)*** of Part II(b).

134. In respect of items that –

(i) were subject to deduction on an equal basis from core capital and supplementary capital under section 48(2) of the pre-amended Capital Rules before 1 January 2013; but

(ii) are subject to deduction from CET1 capital, Additional Tier 1 and/or Tier 2 capital on and after 1 January 2013,

report separately the portions of amount of each individual item that are subject to –

(i) deduction from the institution's CET1 capital, Additional Tier 1 capital and/or Tier 2 capital in Column 1 ***(Amount transitioned)***; and

(ii) transitional 50:50 deduction in Column 3 ***(50:50 deduction - Amount not yet transitioned)*** of Part II(b).

135. The figure reported in Column 1 ***(Amount transitioned)*** of each individual item should be the sum of the portion of amount derived under paragraphs 133 and 134 above. Such amount should be smaller than or equal to the figure of each individual item reported in either Column 1 or Column 2 of Part II(a) of the Return as deduction items incurred after 1 January 2013 that are not subject to transitional arrangements will be aggregated with the amount transitioned and reported in the respective items of Part II(a) of the Return. Please refer to **Annex II-H** for a mapping table on items in this Form and the corresponding items in Part II(a).

136. Figure in Column 4 is the sum of figures reported in Column 1,

2 and 3 of each individual item.

137. Items (11), (11)(a), (16) and (21) are applicable only for institution who calculates its CAR on a solo/solo-consolidated basis under a section 3C requirement.

138. Item (22) refers to the total deductible amount of items subject to 50:50 deduction during the transitional period, which is the sum of items (4) to (21) in Column 3 of Part II(b), except items (8)(a), (9)(a), (10)(a) and (11)(a). The amount of which shall be deducted from the institution's Tier 1 capital and Tier 2 capital on an equal basis and reported in item (i)(vi) and (r)(vi) of Part II(a) respectively.

To avoid doubts, if the amount required to be deducted from Tier 1 capital is greater than the actual amount of Additional Tier 1 capital, the amount of excess must be deducted from the institution's CET1 capital. Similarly, if the amount required to be deducted from Tier 2 capital is greater than the actual amount of Tier 2 capital, the amount of shortfall must be met by the institution's Tier 1 capital.

Hong Kong Monetary Authority
March 2016