Completion Instructions

Return of Large Exposures
Form MA(BS)1D

Introduction

1. This return collects information on authorized institutions' large exposures to banks, non-bank entities and connected parties.

2. These completion instructions contain 2 sections. Section A gives instructions on the general reporting requirements. Section B explains the reporting requirements for each individual item in the return form.

Section A : General Instructions

3. The general reporting requirements for authorized institutions incorporated locally and overseas are as follows: -

	Coverage	Submission deadline
Institutions incorporated in HK	1 return on the combined position of the Hong Kong offices and all overseas branches	Not later than 6 weeks after the end of each quarter
	1 return on the consolidated position of the institution *(Note)	Not later than 6 weeks after the end of each quarter
Institutions incorporated overseas	1 return on the position of HK offices only	Not later than 6 weeks after the end of each quarter

If the submission deadline falls on a public holiday, it will be deferred to the next working day.

*Note: Unless otherwise specified by the Monetary Authority, the subsidiaries to be included for reporting in this return should be the same as those included for calculating the reporting institution's consolidated position under Section 81 of the Banking Ordinance. The Monetary Authority may, by notice in writing, require an institution to include also the exposures of its holding companies or any of the subsidiaries of such holding companies in this return.

4. Inter-branch transactions are not required to be reported under this Return.

5. For the purpose of this return:

(i) "A group of related counterparties" means parties which are connected in such a way that the financial soundness of any of them may affect the financial soundness of the others, e.g.:

(a) companies which are subsidiaries of the same holding company or which have the same controller;

(b) holding company and its subsidiaries; and

(c) counterparties linked by cross guarantees or whose liabilities are guaranteed by the same guarantor.

For the purposes of this return, the central and local governments of a country should be regarded as a group of related counterparties. Other enterprises and agencies established or owned by the central or local governments should however be regarded as separate entities. If the exposures to the enterprises or agencies in question are guaranteed by the central or local governments, they should be reported as guaranteed exposures as illustrated in paragraph 11 of Section A.

For avoidance of doubt, the Exchange Fund should be regarded as part of the Hong Kong Government. Market Makers of Exchange Fund Bills/Notes and other Specified Instruments should report their aggregate long positions in each issue of these instruments as exposures to the Government or the other issuers, as the case may be.

(ii) "Banks" means institutions authorized under the Banking Ordinance, and institutions which are regarded as banks by the appropriate supervisory authorities in their place of incorporation, and include central banks. Include here also large exposures to banks which are connected to the reporting institution.

(iii) "Capital base" of a locally incorporated institution is as defined in the Third Schedule to the Banking Ordinance. Institutions incorporated in overseas countries which have adopted the Basel capital framework should use the capital base of their head offices. Other overseas incorporated institutions may use the capital and reserves (exclude provisions however described) of their head offices in place of capital base. For the purposes of this return, institutions should use the latest capital base figures for reporting: locally incorporated institutions should use the figures as at the end of the previous quarter and overseas incorporated institutions should use the latest figures obtained from their head offices.

(iv) "Commitments and contingencies" refer to the items specified under Table B of the Third Schedule to the Banking Ordinance. But it does not include:

(a) foreign exchange and interest rate contracts which should be reported separately in column (4); and

(b) credit limits which have not been formally advised to a customer.

(v) "Connected parties" refer to counterparties connected to the reporting institution. These include:

(a) intra-group companies: include holding, subsidiary and associated companies of the reporting institution, and other subsidiary and associated companies of the holding company of the reporting institution;

(b) the reporting institution's directors, controllers, minority shareholder controllers, and any 'relative' of these directors, controllers and minority shareholder controllers;

(c) the reporting institution's employees who are responsible for approving loan applications and any 'relative' of these employees;

(d) any firm or company in which the reporting institution or any of its controllers, minority shareholder controllers or directors or any 'relative' of any of its controllers, minority shareholder controllers or directors is interested as director, partner, manager, agent or is the guarantor of the exposure; and

(e) any firm or company in which a person specified in (b) and (c) is able to control.

'relative' is defined in Section 79 of the Banking Ordinance.

(vi) ***"Credit derivatives" are bilateral contracts designed to allow market participants to transfer credit risk on loans and other assets from the protection buyer, to the protection seller. There are generally three types of credit derivatives: credit default swap, total return swap and credit linked note.***

(vii) "Direct exposures" refer to any exposures to a counterparty who is liable to the reporting institution as principal debtor.

(viii) "Exposure" means all potential losses which might result should a particular counterparty default. This generally includes claims, contingencies and commitments recorded both on and off the balance sheet of the reporting institution. It includes assets, such as equities, which do not represent a claim on the counterparty but whose value otherwise depends on that counterparty's financial soundness ***and exposures arising from credit derivative transactions.*** Accrued interest, if any, on an exposure should also be reported. However, any accrued interest which has not been recognised in the profit & loss account but credited as interest in suspense should be netted off against the corresponding amount of interest in suspense whether or not it has been capitalised.

(ix) "Foreign exchange contracts" include cross-currency swaps, forward foreign exchange contracts, currency futures and foreign exchange options purchased.

(x) "Indirect exposures" refer to any exposures to a counterparty who is liable to the reporting institution as guarantor. Any indirect exposures should be categorized under the return as on-balance-sheet exposures, commitments and contingencies or foreign exchange and interest rate contracts in the same way as the relevant direct exposures recorded by the reporting institution.

(xi) "Interest rate contracts" include interest rate swaps, forward rate agreements, interest rate futures and interest rate options purchased.

(xii) "Non-bank entities" refers to parties other than banks and authorized institutions. This includes international organizations, central and local governments, and any other state-owned enterprises (except state-owned banks) and agencies.

(xiii) "Security" refers to tangible assets (e.g. cash deposits, interests in land and buildings and interest in share capital of a company) held by the reporting institution as security. It also refers to guarantees given by a bank or a central government/bank.

6. Report the full value of all exposures except foreign exchange and interest rate contracts. Institutions may leave blank column 4 "Foreign exchange and interest rate contracts" until they are advised of the method of calculation by the Monetary Authority or**,** ***where reporting institutions have developed an internal system to measure their exposures arising from foreign exchange and interest rate contracts by individual counterparties,*** report figures based on ***their own internal analysis (e.g. the calculation of positive replacement cost) or*** internal credit weighting criteria.

7. Exposures arising from items 4, 5 and 6 (i.e. sale and repurchase agreements; assets sales or other transactions with recourse; and forward assets purchases) specified in Table B of the Third Schedule of the Banking Ordinance should be reported as exposures to the issuer of the underlying assets instead of exposures to the counterparty with whom the transaction has been entered into. However, this treatment does not apply to securities transactions.

8. Securities transactions should be reported on "trade date" basis and those under sale and repurchase agreements ("repos") and reverse repos should be reported on an "economic substance" approach (i.e. they are treated as collateralised deposits and loans respectively). For repos, the reporting institution is exposed to the issuer of the securities. For reverse repos, the reporting institution is, in the first instance, exposed to the counterparty. Only in the event of a failure of the counterparty would the reporting institution be exposed to the issuer of the securities acquired. ***The reporting treatment of unmatured spot and forward purchases of securities and of unmatured spot and forward sales of securities should be as for repos and reverse repos respectively.*** Where cash is not involved in these transactions (e.g. securities

repos), the reporting institution is only exposed to the issuer of the securities delivered to the counterparty. ***Where the terms of a repo transfer substantially all the risks and rewards of ownership of the securities to the buyer, the transaction should be regarded as an outright sale and the commitment to repurchase should be reported as an off-balance sheet exposure to the issuer of the securities under the column "Commitments and contingencies". Where the commitment to repurchase has no pre-determined price, the fair value (e.g. current market value) as of the reporting date should be used. On the other hand, if the reporting institution is a buyer of such repo, it should regard the transaction as an outright purchase and treat it as an on-balance sheet exposure to the issuer of the securities.***

9. Credit derivative transactions should be reported in this return as follows:

<u>Protection buyers</u>

A credit default swap or a total return swap which is recognised as a protection of the underlying asset for capital adequacy purpose should be regarded as a guarantee and reported as an indirect off-balance-sheet exposure (commitment and contingencies) to the protection seller in this return. The amount of the exposure is the same amount of protection that can attract the lower risk weight for capital adequacy purposes.

In a credit linked note which is recognised as a protection of the underlying asset for capital adequacy purposes, the protection buyer (the note issuer) should report its exposure to the counterparty of the underlying asset as an exposure secured by a cash deposit. The amount of the secured exposure is the amount of the funds received from issuing the note. The unsecured amount, if there is any, of the exposure to the counterparty of the underlying asset should be reported as a direct exposure.

<u>Protection sellers</u>

For protection sellers, a credit default swap or a total return swap should be treated in the same way as a direct credit substitute and reported as a direct off-balance-sheet exposure (commitment and contingency) to the reference entity in this Return. The amount of the exposure to the reference entity is the maximum amount that could be paid out under the contract. It should, therefore, be the same amount reported for the capital adequacy requirement.

In a credit linked note, the protection seller (the note buyer) has an on-balance-sheet exposure to the note issuer. In addition, the protection seller has an off-balance-sheet direct exposure (commitment and contingency) to the reference entity because of the embedded credit default swap in the note. The amount of this off-balance-sheet exposure which should be reported is the book value of the note.

10. Exposures should be reported in gross <u>before provisions</u> but after netting off the accrued interest against the corresponding interest in suspense as mentioned in paragraph 5 (viii) above. Each reported item should be the aggregate of exposures to an individual counterparty or a group of related counterparties. In the latter case, the

aggregate should be reported as one exposure and shown in the name(s) of the principal counterparty(ies).

11. An exposure under the guarantee of a third party should for the purposes of this return, be regarded as an exposure to the borrower as well as the guarantor unless they both belong to the same group as mentioned in 5(i)(a) and (b) above. For instance, if an institution has granted the following loans to 3 borrowers who have no connection with it:

Borrower	Amount of loans expressed as % of capital base
A	10%
B	10%
C	5%

Assuming that A is the guarantor of the exposures to both B and C, these exposures should be reported as follows:

(a) If A, B and C belong to different groups - report

(i) aggregate exposures to A - 25%, being direct exposures of 10% to A plus guarantees on exposures of 10% to B and 5% to C; and

(ii) exposures to B - 10%.

Since exposures to C is less than 10% of the institution's capital base, there is no need to report this exposure in this return unless the exposure is within the ten largest exposures.

(b) If A and B belong to the same group - report aggregate exposures to Group A+B - 25%, being direct exposures of 10% to A plus its guarantee on exposures of 5% to C and direct exposures of 10% to B.

(c) If A and C belong to the same group - report

(i) aggregate exposures to Group A+C - 25% being direct exposures of l0% to A plus its guarantee on exposures of 10% to B, and direct exposures of 5% to C; and

(ii) exposures to B - 10%.

12. Exposures to a member of a group of related counterparties where such exposures are guaranteed by another member of the same group should be regarded as direct exposures to the whole group. ***Where an aggregate exposure consists of direct and indirect exposures, indicate the portion of direct exposures in percentage terms.***

13. When a reporting institution is exposed to a group of related counterparties containing bank and non-bank entities, report the exposures to the group in either Part II or Part III of the return ***according to the specific instructions in Section B Part II below.***

The reporting institution is required to indicate ***the portion of exposures to banks (or to non-bank entities) in percentage terms in Part II (or Part III) of the return***.

Section B: Specific Instructions

Columns (1) to (5)

Where an exposure has exceeded the relevant reporting threshold during the reporting period, complete columns (1) to (5) of the relevant parts notwithstanding a reduction of the exposure to below the relevant threshold at reporting date. The relevant reporting threshold is set at 5% of capital base for Part I and 10% of capital base for Part II and Part III.

Report in column (1) the maximum exposures to each counterparty during the reporting period, in descending order of the size of exposures. Report in columns (2) to (4) the exposures at the last calendar day of the current quarter. Column (5) is the sum total of columns (2) to (4). It should be expressed as a percentage of the institution's capital base in the next column. (Please refer to point 5(iii) in Section A for definition of "capital base".)

Information on security cover

Where the total market value of the security given is equal to or in excess of the total exposures reported in column (5), put a "F" in the column to indicate that the exposures are fully secured. The column should be reported as "P" (or "U") if an exposure is only partially secured (or unsecured, as the case may be). Where possible a percentage should also be given indicating the proportion of an exposure which is secured.

Part I - Exposures to any ***non-bank*** connected party ***equal to or*** exceeding 5% of capital base during the reporting period

Report in the table the aggregate exposures, both secured and unsecured, to non-bank connected parties, which ***are equal to or*** exceed 5% of the reporting institution's capital base. ***If an exposure to a non-bank connected party is equal to or exceeds 10% of the reporting institution's capital base, such exposure should be reported in Part II again.***

Report in the "memorandum items" the aggregate secured and unsecured exposures to non-bank connected parties outstanding as at the last day of the current quarter. These include exposures which are themselves ***less than*** 5% of the reporting institution's capital base.

Part II - Ten largest ***non-bank*** exposures (and all those ***equal to or*** exceeding 10% of capital base) during the reporting period

Locally incorporated institutions should report the 10 largest exposures and any exposures which ***are equal to or*** exceed 10% of the reporting institution's capital base.

Overseas incorporated institutions are required to report the 10 largest exposures only.

Where an aggregate exposure to a group of related counterparties contains exposures to both bank and non-bank entities and the portion of non-bank exposures is equal to or exceeds 10% of the reporting institution's capital base at the reporting date, the entire exposure should be reported in this Part with the portion of bank exposures indicated in percentage terms. Where the non-bank portion of exposures is less than 10% of its capital base, the reporting institution may report the aggregate exposure in either Part II or III depending on the relative significance of the bank or non-bank exposures.

For the purposes of monitoring compliance with the reporting institution's internal clustering limit for non-exempt large exposures, locally incorporated institutions should also report the amount of each large exposure that is not exempted under Section 81 of the Banking Ordinance as at the reporting date under the column "Exposures not exempted under Section 81" and indicate its percentage of capital base.

Part ***III***- Ten largest bank exposures (and all those ***equal to or*** exceeding 10% of capital base) during the reporting period

Locally incorporated institutions should report the 10 largest exposures and any exposures which ***are equal to or*** exceed 10% of the reporting institution's capital base.

Overseas incorporated institutions are required to report the 10 largest exposures only.

Institutions which provide finance to brokers and customers to subscribe for new shares are exposed indirectly to the credit risk of the receiving bank. Such indirect exposures should be reported under this Part if the total of these exposures and other exposures to the receiving bank has exceeded the reporting threshold.

Hong Kong Monetary Authority
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