Consultation Paper

A Framework for Systemically Important Banks in Hong Kong

Purpose

This paper sets out proposals for establishing and implementing a regulatory and supervisory framework for: (i) identifying and designating authorized institutions (“AIs”) as domestic systemically important banks (“D-SIBs”) in Hong Kong; and (ii) applying a range of prudential and supervisory requirements to the AIs so designated.

The Hong Kong Monetary Authority (“HKMA”) invites the banking industry’s comments on the proposals in this paper and, in this regard, would be grateful if the industry’s comments could be provided by 26 May 2014.

Following the close of this consultation, the HKMA will further develop and refine its proposals for the local D-SIB framework, taking into account the feedback received, with a view to: (i) issuing a new Supervisory Policy Manual (“SPM”) module in the course of 2014 setting out the process and methodology for identifying D-SIBs, and the regulatory and supervisory framework that will apply to AIs identified as D-SIBs (in accordance with the HKMA’s usual practice, the industry will be consulted on the draft text of the SPM module before it is finalised); and (ii) amending the Banking (Capital) Rules (“BCR”) and Banking (Disclosure) Rules (“BDR”) as necessary to support the operation of the framework. As required by the Banking Ordinance, the
industry Associations will be consulted on the proposed amendments to the Rules before they go into effect.
1. BACKGROUND

1. In the wake of the recent global financial crisis, the G20 Leaders charged the Financial Stability Board ("FSB") with the task of developing a policy framework to address the systemic risks, and reduce the moral hazard, posed by systemically important financial institutions ("SIFIs").

2. The rationale for adopting additional policy measures for SIFIs is the significant “negative externalities” (i.e. adverse impacts) which these systemically important institutions could create if they were to become non-viable. These externalities are not fully addressed by current regulatory policies which tend to be focussed on individual institution, rather than broader systemic, risks. Financial institutions may quite rationally pursue outcomes that benefit the individual institution but that, from a system-wide perspective, are sub-optimal because they do not take into account the spillover effects. In the recent crisis, faced with the prospect of financial instability (and consequent negative knock-on effects to the broader economy) from the potential failure of a number of SIFIs, some governments had little choice but to bail-out these institutions using unprecedented amounts of public funds, because the alternative of liquidation and the resulting abrupt termination of financial services was not a realistic option. The moral hazard associated with these bail-outs and any expectations of support thereby created, might, in turn, have the potential to amplify risk-taking, reduce market discipline, create competitive distortions, and further increase the probability of distress in the future.
3. In an attempt to redress the balance, significant progress has been made by international standard setting bodies in addressing the risks posed by banks that are considered to be systemically important at a global level. A framework for global systemically important banks (“G-SIBs”) (“the G-SIB framework”) was first issued by the Basel Committee on Banking Supervision (“BCBS”) in November 2011, setting out an assessment methodology for identifying G-SIBs, and calibrating the magnitude of a higher loss absorbency capital requirement (“HLA”, expressed in terms of Common Equity Tier 1, or “CET1” capital) that would apply to a G-SIB according to its perceived degree of systemic importance. The G-SIB framework was subsequently updated in July 2013 and disclosure requirements were added to the effect that all banks with a total exposure measure (calculated by reference to the Basel III Leverage Ratio methodology) of over EUR 200bn should publish figures in respect of the set of 12 indicators used for assessing systemic importance under the G-SIB framework.

4. Recognising that similar negative externalities can apply at a domestic level, the G-SIB framework has been adapted for use with D-SIBs. A principles-based framework for D-SIBs (“the D-SIB framework”) was finalised by the BCBS in October 2012 to provide a complementary perspective to the global framework. The D-SIB framework focuses on the impact that the distress of

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1 The 12 indicators are: cross-jurisdictional claims; cross-jurisdictional liabilities; total exposures as defined for use in the Basel III leverage ratio; intra-financial system assets; intra-financial system liabilities; securities outstanding; assets under custody; payments activity; underwritten transactions in debt and equity markets; notional amount of over-the-counter derivatives; level 3 assets; and trading and available-for-sale securities.

2 See Dealing with domestic systemically important banks: framework, issued by the BCBS: http://www.bis.org/publ/bcbs233.pdf
banks (including international banks) may have on a jurisdiction’s domestic economy. The D-SIB framework comprises a set of twelve principles (“the D-SIB Principles”) which broadly fall into two main areas: the manner in which a bank may be assessed to be a D-SIB (Principles 1-7) and the HLA requirements applicable to a bank upon its designation as a D-SIB (Principles 8-12). National authorities are responsible for establishing their own methodology for assessing the degree to which banks are systemically important in their domestic context (Principle 1), and calibrating the level of HLA requirement (Principle 8), as well as for determining other policy measures they consider appropriate to address the risks posed by a D-SIB (Principle 12).

5. In this latter context, in a number of recent policy consultations by the BCBS and the FSB, a more stringent or prioritised application of the proposed policy measures has been suggested for D-SIBs. (These policy proposals are summarised in the Annex to this consultation paper.)

6. In particular, intensive supervision and recovery and resolution planning are commonly regarded as the two other key “pillars” of the SIFI framework (in addition to HLA). The broad aim of the D-SIB framework is twofold:

- to reduce the probability of failure of D-SIBs by increasing their going-concern loss absorbency, and by increasing the intensity of supervision for D-SIBs; and
• to reduce the extent or impact of failure of D-SIBs, by requiring recovery planning for, and improving the resolvability of, these banks.

7. As a member of the FSB and the BCBS, it is incumbent upon the HKMA (and the HKMA considers it important from a prudential perspective) to put a D-SIB framework in place in Hong Kong in line with the BCBS guidance. The size of the Hong Kong banking sector is large in comparison to the local economy; as of June 2012, the total assets of the banking system in Hong Kong were 700% of GDP. Moreover, with over 70 of the largest 100 banks in the world operating in Hong Kong, the local banking sector is diversified with extensive links to both the domestic and the global economy. Hence there is potential for shocks affecting banks and the banking sector to pose significant risks to financial stability and to spill-over into the broader economy. These risks have not been fully addressed in the Basel III framework, which focuses primarily on addressing the risks faced by individual banks rather than the risks such banks pose to the system as a whole. The D-SIB framework is specifically intended to address the system-wide perspective, and hence complements Basel III.

8. The HKMA therefore proposes to establish and implement a framework for D-SIBs in Hong Kong covering the key elements in chart 1.
9. In addition to implementing a D-SIB framework locally, the HKMA is committed to ensuring that the G-SIB framework can operate effectively in Hong Kong. Although, as yet there are no G-SIBs for which the HKMA is the home supervisory authority, there is still a need to provide a mechanism by which the HKMA can in future identify and designate an AI as a G-SIB in accordance with the BCBS G-SIB framework. Accordingly, the BCR and BDR will be amended to recognise both D-SIB and G-SIB designation and provide for the consequent application of HLA requirements.

10. This consultation paper has been organised as follows: Section 2 describes the manner in which the HKMA proposes to identify D-SIBs; Section 3 discusses the proposed policy measures for reducing the probability of failure of D-SIBs; and Section 4 presents the proposed policy measures for reducing the impact
of failure of D-SIBs. Section 5 seeks to gauge the views of the industry on quarterly disclosures by D-SIBs of certain key quantitative metrics in line with the BCBS standards. Section 6 discusses the implementation of the G-SIB framework in Hong Kong, followed by Section 7 which considers the implementation and phase-in arrangements.
2. IDENTIFICATION OF D-SIBS

11. Under the D-SIB framework developed by the BCBS, national authorities are required to establish a methodology for assessing the degree to which banks are systemically important in a domestic context (Principle 1). This D-SIB assessment methodology should reflect the potential impact of a bank’s failure (Principle 2). The reference system for assessing the impact of failure of a D-SIB should be the domestic economy (Principle 3). The impact of a D-SIB’s failure on the domestic economy should be assessed having regard to four bank-specific factors: (i) size; (ii) interconnectedness; (iii) substitutability/financial institution infrastructure; and (iv) complexity (Principle 5).

12. In seeking to identify appropriate indicators for the purpose of assessing AIs in Hong Kong against the four bank-specific factors, consideration has been given to the following:

**Objective:** The overarching objective for the D-SIB methodology is to identify AIs whose impact, in the event of distress or failure, would cause significant disruption to the financial system and economic activity locally. The BCBS depicts this as a “loss given default” concept rather than a “probability of default” concept. The indicators proposed are therefore focussed primarily on measures of the “impact of failure”, as opposed to measures of “risk of failure”.

**Domestic context:** One of the key aspects that shapes the D-SIB framework and defines its relationship with the G-SIB framework is the reference system for assessing systemic impact. As noted in paragraph 11, the reference system for the D-SIB framework is the domestic economy. As such, the assessment should focus on addressing the externalities generated at a local level on the domestic economy, which could be caused by the distress or failure of a bank (including an international bank).

### 2.1 Proposed scope of assessment for D-SIBs

13. The HKMA proposes to include all licensed banks (“LBs”) within the assessment sample for the D-SIB framework. The HKMA believes that this should provide an appropriate degree of coverage for the D-SIB framework.

14. Whilst it is conceivable that restricted licence banks (“RLBs”) and deposit-taking companies (“DTCs”) could generate some adverse effects on the domestic economy under stressed conditions, the limited scale and nature of the activities of RLBs and DTCs, generally speaking, make it less likely that their individual failure could create systemic externalities for the domestic economy. In the interest of taking a proportionate approach in implementing a D-SIB framework in Hong Kong, the HKMA does not therefore propose to routinely include RLBs and DTCs within the scope of the D-SIB assessment exercise, although individual RLBs and DTCs may be added to the assessment
sample on a case-by-case basis in instances where the externalities potentially associated with them may be of systemic concern.

2.2 Proposed basis of assessment for D-SIBs

15. The BCBS D-SIB framework makes clear that the “unit of analysis”, or the basis of assessment for D-SIBs, should be considered from a “(globally) consolidated perspective”. Furthermore, when it comes to host authorities, the BCBS is of the view that foreign subsidiaries in national jurisdictions should “also be consolidated to include any of their own downstream subsidiaries, some of which may be in other jurisdictions”.

16. In accordance with the above, the HKMA proposes to assess all LBs (and any other AIs within the scope of D-SIB assessment) on a consolidated basis to the extent possible. Overseas incorporated licensed banks are proposed to be assessed on a Hong Kong office basis, commensurate with their form of operations in Hong Kong.

2.3 Data sources and availability

17. National authorities are expected to undertake D-SIB assessments on a regular basis, so it is important that data sources for the identified indicators are readily accessible and reliable. However, it should be noted that the availability of suitable and readily available data for the assessment of D-SIBs

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3 See paragraph 18 of the BCBS D-SIB framework.
4 See paragraph 19 of the BCBS D-SIB framework.
varies depending upon the chosen basis of assessment. For example, existing regulatory returns data seems not to be the most relevant or appropriate for the purposes of assessing D-SIBs from a consolidated perspective, as the majority of existing regulatory returns collect information on a Hong Kong office basis or on a “combined” basis of Hong Kong office and overseas branches, but not from a consolidated perspective including downstream subsidiaries. For assessing LBs on a consolidated basis, the HKMA has considered other data sources, notably the data items disclosed under the BDR, where certain items are required to be disclosed on a consolidated basis.

18. Whilst consolidated level data is largely available publicly pursuant to disclosure requirements, in order to streamline the data source and to facilitate the D-SIB assessment process the HKMA proposes to request AIs within the scope of the D-SIB assessment to formally submit selected data items for relevant indicators on a consolidated basis, through the creation of a new regulatory return. The HKMA does not envisage that the completion of this new return will be unduly burdensome for AIs, as it will only seek to collate data items that AIs already disclose under the BDR in a designated return format for the purpose of facilitating the D-SIB assessment process.

19. Prior to the data collation process being fully automated through the new return as described in paragraph 18, the HKMA would propose to initially base its D-SIB assessment on existing returns data (on a Hong Kong office basis) as a starting point, and adjust certain significant data items manually in order to conduct its assessment from a consolidated perspective. The HKMA plans to introduce the new return as soon as reasonably practicable so that the
D-SIB assessment can be carried out on a consolidated basis using a single data source at the earliest feasible opportunity.

Q1: Does the industry agree that, from the perspective of proportionality and simplicity, the scope of assessment for D-SIBs should largely be confined to licensed banks?

Q2: In view of the fact that the proposed new return will in effect collate existing disclosure items, does the industry have any views on the timeline necessary for the introduction of the return? If the return were finalised by September 2014, could it be implemented by January 2015 for instance?

2.4 Proposed indicators for assessment of D-SIBs

20. The HKMA proposes to adopt all four factors in Principle 5 of the BCBS D-SIB framework (see paragraph 11) in its assessment of the systemic importance of AIs locally.

2.4.1 Size

21. As noted in the G-SIB framework, size is a key measure of systemic importance. The larger the AI, the more widespread the effect of a sudden withdrawal of its services and therefore the greater the chance that its distress
or failure would cause disruption to the financial markets and systems in which it operates, and to the broader functioning of the economy.

22. The HKMA proposes to use a “total assets” measure as the size indicator for the local D-SIB framework. The size indicator used in the G-SIB framework, namely the Basel III Leverage Ratio total exposure measure, has also been considered. However, only locally incorporated AIs will be required to report the Basel III Leverage Ratio exposure measure to the HKMA during the reporting period until 2015 (as specified in the BCBS Basel III transitional timeline), so the HKMA would not necessarily be able to assess all AIs within scope by reference to common factors and indicators if the size indicator under the G-SIB framework were to be adopted.

23. Accordingly, the HKMA does not currently propose to use the Basel III Leverage Ratio total exposure measure in the domestic framework as data is not readily available currently. However, the HKMA may revisit the potential use of this indicator in future reviews of the methodology. In any case, total exposure under the Basel III Leverage Ratio will nevertheless remain an important measure for some of the largest locally incorporated AIs in Hong Kong, not least because the disclosure requirements under the G-SIB framework oblige banking groups with a Leverage Ratio total exposure measure exceeding EUR 200bn to make information publicly available in
respect of each of the 12 indicators used in the G-SIB assessment methodology (as indicated in paragraph 3 above).  

2.4.2 **Interconnectedness**

24. The interconnectedness measure in the G-SIB framework captures the extent of a bank’s interconnections vis-à-vis other financial institutions, irrespective of the location of such institutions or the jurisdiction of their incorporation. For the purpose of a domestic framework, however, given the reference system for assessing the impact of a D-SIB is the domestic economy, this factor should focus on the interconnections that would give rise to externalities affecting the domestic financial system and economy.

25. To reflect this narrower focus, the HKMA proposes to adopt the following indicators for AIs’ **interconnectedness** within Hong Kong:

i. “placement with banks”;  
ii. “deposits and balances from banks”; and  
iii. “loans to financial concerns”.

26. The HKMA considers that multiple indicators are warranted for capturing the interconnections both to, and from, AIs within the financial system in Hong Kong. The “placement with banks” and “deposits and balances from banks” categories should give a broad sense of the extent of each AI’s

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5 The HKMA will be making the necessary amendments to the BDR in order to accommodate this requirement over the course of 2014.
interconnectedness within the banking sector at an aggregate level, whereas the “loans to financial concerns” is intended to provide some indication of an AI’s exposure to (and interconnectedness with) the wider financial system.

27. The quantitative indicators proposed in paragraph 25 may only be able to provide a rough and ready sense of the volume of interconnections at an aggregate level. In addition to the proposed quantitative indicators, the HKMA will therefore seek to complement the assessment of interconnectedness by conducting qualitative analysis of interconnections within the financial system, for example by analysing the bi-lateral interbank positions of the major AIs in Hong Kong using large exposures data. This should shed some more light on the actual network structure and behaviour in Hong Kong and, in turn, deepen the HKMA’s understanding of how the interconnections affect the level of systemic importance of individual AIs.

2.4.3 Substitutability / financial institution infrastructure

28. The concept underlying substitutability as a factor for assessing systemic importance recognises that: the greater the role of a bank in a particular business line (or in acting as a service provider in underlying market infrastructure), the more difficult it will be to replace that bank and the extent of the products and services it offers, and therefore the more significant the risk of disruption in the event that the bank becomes distressed.
29. There are a number of functions performed by some AIs in Hong Kong that would obviously be difficult, if not impossible, to substitute at short notice. These include:

i. Payment and Settlement systems. Some AIs perform unique or exclusive roles for the financial system infrastructure in Hong Kong, for example, the role of the settlement institution for the Real Time Gross Settlement (“RTGS”) systems for the USD/EUR/RMB.

ii. Currency banknote issuance. One of the specificities of the local banking sector is that some banks perform functions in Hong Kong in relation to banknote issuance that would more typically be carried out by central banks elsewhere.

30. The HKMA will take into account the functions that are both hard to substitute and critical to the functioning of the Hong Kong banking sector in a qualitative manner in the D-SIB assessment process. Those AIs that perform the most critical and difficult-to-substitute functions (including those described in paragraph 29 above) will likely be considered D-SIBs.

31. Turning to the more common services and functions provided by AIs to the general public in Hong Kong, such as deposit taking and lending to customers, whilst these functions may be seen as more readily substitutable given that virtually all AIs perform these roles, it may nevertheless be the case that a certain “critical mass” in terms of market share may in reality make it difficult
to substitute a significant market player. Hence given the critical importance of these functions to the public, the HKMA proposes to take into account market share in respect of essential functions, and intends to incorporate “deposits from customers” and “loans and advances to customers” as quantitative indicators for substitutability. This is based on the logic that the higher the market share of an AI, the more difficult it will be to substitute the extent and level of service it provides.

2.4.4 Complexity

32. The degree of complexity of a bank is generally expected to be proportionately related to the systemic impact of the bank’s distress, since the less complex a bank is, the more “resolvable” it will likely be, and in turn the more likely the impact of its failure could be contained.

33. The HKMA has so far not identified any suitable and readily available quantitative indicator for measuring complexity locally. The three complexity indicators used in the G-SIB framework, namely “OTC derivatives notional value”, “Level 3 assets” and “Held for trading and available for sale value” have been considered, but the HKMA’s preliminary view is that a purely qualitative approach would allow for a more comprehensive assessment to accommodate the multifaceted nature of complexity, and hence would be preferable to a potentially blunter quantitative approach. In particular, a qualitative approach would allow the HKMA to better take into account the various sources of complexity, such as any structural complexity arising from
the composition of an AI’s group structure; business complexity arising from a significant degree of involvement in complex financial products; or operational complexity in internal systems (e.g. booking practices).

34. The proposed qualitative input into the D-SIB assessment process would be informed by information gathered from regular supervisory interactions, and would take into account the resolution planning and resolvability assessments to be conducted in the future.

Q3: Does the industry have any comments on the suitability of the proposed indicators for tracking the four bank-specific assessment factors?

Q4: Are there any additional factors or indicators that the HKMA should consider for assessing the systemic importance of AIs in Hong Kong?

Q5: In addition to the functions identified in paragraph 29, are there any other functions provided by AIs, or niche business models operated by AIs, that may be critical and difficult to substitute, and that therefore should be taken into account in assessing substitutability?

Q6: Does the industry have any suggestions for a suitable quantitative indicator of complexity? Or does the industry agree that a qualitative approach is preferable for incorporating complexity into the D-SIB assessment process?
2.5 Proposed D-SIB assessment methodology

35. The BCBS adopts an indicator-based measurement approach in its assessment methodology for G-SIBs, which gives equal weight to each of the five factors\(^6\) for identifying global systemic importance, and which is supported by supervisory judgement, guided by a set of criteria.

36. The HKMA intends to adopt a similar indicator-based measurement approach as a basis for identifying D-SIBs. Subsection 2.6 below describes further how the HKMA proposes to incorporate the factors and quantitative indicators described in subsection 2.4 within its proposed quantitative indicator-based approach.

37. In addition, consistent with the G-SIB framework, the HKMA is also of the view that a robust assessment approach cannot rely solely or mechanically on quantitative indicators, but qualitative information and judgement have a role to play and should therefore be incorporated appropriately. Indeed, as discussed in the previous section, some of the most effective factors for assessing systemic importance tend not to be of a quantitative nature. Qualitative consideration of the composition of an AI’s group structure could, for example, be valuable in informing assessments of the degree of an AI’s complexity, but may not be readily quantifiable. The HKMA therefore considers that the incorporation of qualitative indicators using supervisory judgement will always be necessary in the D-SIB identification process. To

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\(^6\) The five factors in the G-SIB framework are: size, cross-jurisdictional activity, interconnectedness, substitutability/financial institution infrastructure and complexity.
ensure that qualitative information is considered in a consistent and appropriate manner, however, the HKMA proposes to put in place a set of guiding criteria, as discussed in subsection 2.7.

2.6 Quantitative indicator-based approach

38. Whilst the HKMA proposes to use a quantitative indicator-based approach, similar to that in the G-SIB framework, for the purpose of identifying D-SIBs, the HKMA does not however propose to adopt the “equal weighting” approach used in the G-SIB framework. Instead, the HKMA proposes to assign a higher weighting to the size indicator, and (as discussed in paragraph 33) take complexity into account using a purely qualitative approach.

39. There are a number of rationales for departing from the “equal weighting” approach and assigning a higher weight to size as compared to the other quantitative indicators. Firstly, out of the four factors, size is considered to be the single most dependable quantitative indicator in terms of data reliability and objectivity. In most cases the HKMA envisages that it will be far less reliant on qualitative indicators in relation to size as compared to the other factors.

40. More crucially, the HKMA assesses that size is genuinely a more important measure of systemic importance than other factors and indicators. Generally speaking, the larger the size of an AI, the greater its market share of critical financial services and the more interconnected it is to the banking sector and
the domestic economy, and therefore the more difficult to substitute. In addition, in the event of any impairment or failure of an AI, the larger the AI, the more likely it will have a damaging effect on the confidence in, and the stability of, the banking system as a whole.

41. As such, the HKMA proposes applying a 50% weighting to the size indicator. Consequently, the quantitative indicators for interconnectedness and substitutability are given lower weights, with a proposed weighting of 25% for each factor respectively:

<table>
<thead>
<tr>
<th>Factor</th>
<th>Quantitative Indicator</th>
<th>Indicator weighting</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Size (50%)</strong></td>
<td>Total assets</td>
<td>50%</td>
</tr>
<tr>
<td><strong>Interconnectedness (25%)</strong></td>
<td>Interconnectedness within the banking system (12.5%)</td>
<td>Placements with banks</td>
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<td></td>
<td></td>
<td>Loans and advances from banks</td>
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<tr>
<td></td>
<td>Interconnectedness with the financial system: (12.5%)</td>
<td>Loans to financial concerns</td>
</tr>
<tr>
<td><strong>Substitutability / financial institution infrastructure (25%)</strong></td>
<td>Deposits from customers</td>
<td>12.5%</td>
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<tr>
<td></td>
<td>Loans and advances to customers</td>
<td>12.5%</td>
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</tbody>
</table>

42. It should be noted that while the quantitative indicators for determining interconnectedness and substitutability attract a lower weighting under the
HKMA’s proposal (and the complexity factor is proposed to have no quantitative input at all), each of these factors will be supplemented by qualitative indicators as discussed earlier in paragraphs 21 to 34.

Q7: Does the industry agree that the quantitative indicator for size warrants a higher weighting in the local D-SIB assessment methodology as compared to the quantitative indicators for interconnectedness and substitutability?

2.7 Incorporation of qualitative indicators using supervisory judgement

43. The HKMA has identified a number of qualitative indicators relating to specific aspects of the systemic importance of an AI that may not otherwise be captured by the quantitative indicator-based measurement approach. An illustrative list of these indicators is set out in table 2 below. These indicators may be used to support the exercise of supervisory judgement by the HKMA in assessing which AIs should be designated as D-SIBs.

Table 2: Illustrative list of qualitative indicators

<table>
<thead>
<tr>
<th>Factor</th>
<th>Qualitative indicator</th>
</tr>
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<tbody>
<tr>
<td><strong>Size</strong></td>
<td>Anticipated business expansion or contraction, mergers or acquisitions, or other business initiatives that will likely result in significant change in an AI’s size</td>
</tr>
<tr>
<td><strong>Interconnectedness</strong></td>
<td>Qualitative analysis of interconnectedness, e.g. by analysing interbank positions</td>
</tr>
</tbody>
</table>
**Substitutability / financial institution infrastructure**

<table>
<thead>
<tr>
<th>Provision of key financial infrastructure and critical functions in Hong Kong, e.g. settlement institutions, note-issuing banks</th>
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**Complexity**

<table>
<thead>
<tr>
<th>Structural complexity, e.g. composition of group structure</th>
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<tbody>
<tr>
<td>Business complexity, e.g. significant degree of involvement in complex financial products</td>
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<tr>
<td>Operational complexity</td>
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<tr>
<td>Findings from resolvability assessments (in future)</td>
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</table>

44. To ensure that the qualitative indicators will be considered in a consistent manner, the HKMA proposes to put in place a set of criteria to guide the incorporation of supervisory judgement into the operation of the D-SIB framework. This will be similar to the set of guiding criteria adopted in the G-SIB framework. So, for example,

- due consideration should be given to the qualitative indicators that cannot be captured quantitatively, including all the pre-identified principal qualitative indicators listed in table 2;

- supervisory judgemental overlay may serve as a substantive input to the identification of D-SIBs. This is especially the case for the incorporation of any factors that are not being captured by quantitative indicators (e.g. complexity);

- any supervisory judgemental overlay should be based upon well-documented and verifiable quantitative as well as qualitative
information. To this end, the HKMA intends to document the principal qualitative indicators that will typically be considered in the process of applying supervisory judgement (in a format similar to table 2) in the relevant SPM module and to review and update them periodically in light of implementation experience.

- the process should focus on factors and indicators pertaining to an AI’s domestic systemic impact, i.e. the *impact* given the AI’s distress/failure and not the *probability* of distress/failure of the AI; and

- views on the quality of the policy/resolution framework within a jurisdiction should not play a role in the D-SIB identification process.\(^7\)

Q8: Does the industry have any suggestions on any other qualitative indicators which might usefully be taken into account in the D-SIB assessment process?

Q9: Does the industry have any suggestions relating to the criteria to guide the incorporation of supervisory judgement into the assessment process?

\(^7\) While the HKMA is of the view that the quality of the policy/resolution framework within a jurisdiction should not play a role in the D-SIB identification process, it is nevertheless the HKMA’s intention to take into account the resolvability of an individual AI as one of the qualitative indicators for assessing complexity as the local resolvability assessment process is established and implemented.
2.8 **Approach to establishing a cut-off threshold for the identification of D-SIBs**

45. The establishment of any “cut-off” threshold will necessarily involve supervisory judgement. For the purposes of determining the threshold, the HKMA proposes to undertake supplementary analyses, including cluster analysis, to ascertain if there is any natural “break” between different “clusters” of potential systemic impact.
3. REDUCING THE PROBABILITY OF FAILURE

3.1 Higher loss absorbency requirements

3.1.1 Background

46. As explained in paragraph 6, the rationale for imposing higher loss absorbency requirements (in terms of additional CET1 capital) on D-SIBs is to reduce the probability of their failure, in view of the greater impact that this would likely have on the domestic financial system and the local economy more broadly.

47. The HLA requirement is in effect another layer, or buffer, of the highest quality loss-absorbing capital under the Basel regulatory capital standard. Similar to the countercyclical capital buffer, the HLA requirement will essentially take effect as an extension of the Basel III capital conservation buffer.

48. As such, the HLA requirement is not designed to be, and should not be regarded as, a “hard” minimum, the breach of which would necessarily imply a “failure” by a D-SIB to comply with minimum capital requirements. A D-SIB’s CET1 capital ratio can fall within the range of the HLA requirement (or, more precisely within the range of the capital conservation buffer, as extended by the HLA requirement). However, if and when it does so, the D-SIB will be subject to restrictions on the distributions it may make (including by way of dividend, share buyback, discretionary coupon payments on capital
instruments and discretionary bonus payments to staff) according to a specified scale. In other words, for so long as they are below the upper level of their buffer requirement, D-SIBs will be required to retain earnings in order to bolster their capital and will be incentivised to raise capital if they want to make payments in excess of the constraints imposed.

49. Section 97C of the Banking Ordinance provides for the HKMA to make rules prescribing capital requirements for AIs incorporated in Hong Kong. Such rules may make different provisions for different classes of AIs, taking into account the risks associated with institutions belonging to each class; they may give effect to banking supervisory standards relating to capital issued by the BCBS subject to any modifications the HKMA thinks fit, having regard to local circumstances and they may prescribe a capital requirement in the form of a range with upper and lower limits and the circumstances under which the HKMA may determine a specific capital requirement within that range to apply to an AI. The existing BCR were issued pursuant to section 97C and amendments will be made to the BCR to empower the HKMA to impose the HLA requirement on D-SIBs designated by the HKMA. In accordance with the HKMA’s usual practice, and as required by section 97C of the Banking Ordinance, the industry will be consulted upon the proposed amendments to the BCR in due course.
50. While there are currently no locally incorporated AIs designated as G-SIBs as noted in paragraph 9, the HKMA will nevertheless make provision within the amendments to the BCR to cater for the future eventuality of a local banking group becoming a G-SIB. This will include a power for the HKMA to designate AIs as G-SIBs in future, if and when necessary, and to impose an HLA requirement on any such G-SIBs so designated. The HKMA’s intentions with regard to the operation of the G-SIB framework in Hong Kong are set out in Section 6 of this consultation paper.

51. In the event that a local banking group for which the HKMA is the home authority is designated as a G-SIB, it is quite likely that such G-SIB will also be designated a D-SIB in Hong Kong. In such instance, the HKMA would propose to impose the higher of the applicable D-SIB or G-SIB HLA requirement, in accordance with Principle 10 of the BCBS D-SIB Principles which provides that:

“Home authorities should impose the higher of either the D-SIB or G-SIB HLA requirements in the case where the banking group has been identified as a D-SIB in the home jurisdiction as well as a G-SIB.”

3.1.2 “Bucketing” approach

52. The G-SIB framework takes a differentiated approach to the HLA requirement for G-SIBs whereby the G-SIBs are allocated to “buckets” corresponding to a

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8 As per the latest list of G-SIBs published by the FSB in November 2013: https://www.financialstabilityboard.org/publications/r_131111.pdf
required level of HLA ranging from CET1 equivalent to 1% to 2.5% of risk weighted assets, with an empty top bucket of 3.5%, to provide incentives for G-SIBs to refrain from becoming yet more systemically important (see table 3). Nationally, some jurisdictions have adopted a similar “bucketing” approach for their D-SIB framework, but there are also examples of jurisdictions proposing a flat HLA surcharge across all of their D-SIBs.

Table 3: The G-SIB bucketing approach

<table>
<thead>
<tr>
<th>Bucket</th>
<th>Score range</th>
<th>Higher loss absorbency requirement (common equity as a percentage of risk-weighted assets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>D-E</td>
<td>3.5%</td>
</tr>
<tr>
<td>4</td>
<td>C-D</td>
<td>2.5%</td>
</tr>
<tr>
<td>3</td>
<td>B-C</td>
<td>2%</td>
</tr>
<tr>
<td>2</td>
<td>A-B</td>
<td>1.5%</td>
</tr>
<tr>
<td>1</td>
<td>Cut-off point - A</td>
<td>1%</td>
</tr>
</tbody>
</table>

53. According to the BCBS D-SIB Principles, national authorities should determine the required level of HLA requirements for D-SIBs in a manner “commensurate with the degree of systemic importance, as identified under Principle 5” (the assessment methodology) (Principle 9). Given the diversified nature of the local banking sector and the varying degree of systemic importance likely to be observed amongst local D-SIBs, the HKMA is inclined to adopt a differentiated approach to the local HLA requirement for D-SIBs using a bucketing approach broadly consistent with the G-SIB framework, to ensure the framework provides appropriate incentives.
54. The number of buckets and the level of HLA requirement associated with each bucket will be determined in due course, following further data calibration exercises based on the methodology described in this paper, taking into account the feedback received from the industry.

55. The HKMA proposes to specify the range of HLA within the BCR. Based on a preliminary calibration exercise carried out using the systemic scores derived from the identification methodology proposed in this consultation paper, the HKMA is contemplating an HLA requirement ranging from 1% to 2.5% for D-SIBs in Hong Kong. However, it is proposed to set a wider range in the BCR, say 1% to 3.5%, in order to allow room for an empty top bucket to provide an incentive for the most systemically important D-SIBs to refrain from becoming even more systemically important. This would be in line with the G-SIB framework.

Q10: Given the likely degree of difference in the “systemic-ness” of the local D-SIBs, does the industry agree that a differentiated, rather than a flat-rate, approach to the assessment of HLA is merited?

Q11: Does the industry consider a bucketing approach, broadly reflective of that in the G-SIB framework, appropriate to achieve the differentiated HLA requirements?
3.2 Application of HLA requirement to different types of AIs designated as D-SIBs

3.2.1 Locally-incorporated AIs

56. To ensure that the application of the G-SIB and D-SIB framework is compatible globally and between national jurisdictions, Principle 10 of the BCBS D-SIB Principles draws a distinction between the level of application of D-SIB HLA requirements for home and host authorities:

“Home authorities should impose HLA requirements that they calibrate at the parent and/or consolidated level, and host authorities should impose HLA requirements that they calibrate at the sub-consolidated/subsidiary level.”

57. Accordingly, and in keeping with its usual approach to the implementation of the Basel regulatory capital framework, the HKMA proposes to impose the HLA requirement at both solo and consolidated level on D-SIBs that are locally incorporated AIs for which the HKMA is the home authority, and at the subsidiary and sub-consolidated level on D-SIBs that are subsidiaries of foreign banking groups.

3.2.1.1 Subsidiaries of foreign banking groups

58. The BCBS D-SIB Principles allow host authorities to apply the D-SIB framework to a bank regardless of whether it is a subsidiary of a foreign banking group.
banking group, or a subsidiary of a G-SIB. As explained in the D-SIB framework, the objective of the host authorities’ power to impose HLA on subsidiaries is to bolster capital in order to mitigate the potential heightened impact of the subsidiaries’ failure on the domestic economy due to their systemic nature.⁹

59. Principle 11 of the BCBS D-SIB Principles further specifies that in such cases, home and host authorities should make arrangements to coordinate and cooperate on the appropriate HLA requirements, within the constraints imposed by relevant local laws and regulations. Consistent with the BCBS D-SIB framework¹⁰, the HKMA will consider whether any actions need to be taken for the purpose of strengthening the basis of home-host coordination in this regard, for example by amending existing, or entering into further, Memoranda of Understanding (MoU). The HKMA will also enter into discussion with the relevant home authority in respect of: (i) the resolution regimes (including recovery and resolution plans) in both jurisdictions, (ii) possible resolution strategies and any specific resolution plan in place for the D-SIB, and (iii) the extent to which such arrangements should influence the respective HLA requirements.

60. In addition, for any D-SIB that is a subsidiary of a foreign G-SIB and/or of a foreign bank that is a D-SIB in its home jurisdiction, the HKMA proposes to assess whether some degree of reliance may be placed on the “group” HLA

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⁹ See paragraph 37 of the BCBS D-SIB framework.
¹⁰ See paragraph 43 of the BCBS D-SIB framework.
requirement.\textsuperscript{11} If there are clear and credible assurances from the parent bank in terms of forthcoming capital support should the subsidiary come under stress, and there is a demonstrable ability to execute such support, with no apparent restrictions and with no objections from the home authority, the HKMA may consider allowing such subsidiary to be subject to a lower HLA requirement locally.

3.2.2 \textit{Foreign bank branches}

61. Since the primary responsibility for supervising capital adequacy in respect of foreign bank branches rests with the home supervisory authority, such branches are not subject to capital adequacy requirements in Hong Kong. Accordingly, the HKMA would not propose to introduce any HLA (effectively branch capital requirements) on foreign bank branches. In the event that a foreign bank branch is considered a D-SIB in Hong Kong, the HKMA will however examine whether there is a need to adopt a more intensive regulatory and supervisory approach in relation to it. In cases where, notwithstanding such measures, the HKMA still considers it needs greater ability to regulate and supervise the branch more closely in order to promote the general stability and effective working of the banking system in Hong Kong, the HKMA may consider whether there is a case for the AI to be required to operate locally through a subsidiary rather than a branch.

\textsuperscript{11} According to Principle 10 of the BCBS D-SIB Principles, the HLA requirement imposed at the parent level by the home authority should be calibrated at the parent and/or consolidated level. Globally, the assessment of the systemic importance of G-SIBs is made using data that relate to the consolidated group.
62. In determining the most appropriate supervisory and regulatory approach for foreign bank branches that are local D-SIBs, the HKMA will take into account a number of factors, including the local operations of the branch and the home authority’s supervision and regulation of the group (and therefore the extent to which the HKMA can rely on the home authority), in order to assess the risks posed by the branch to financial stability in Hong Kong. As with foreign bank subsidiaries, the HKMA will seek to cooperate with the home authority in making such assessments focusing, among other things, on the adequacy of capital and liquidity levels held at the parent group, and the parent group’s relationship with the foreign bank branch in Hong Kong.

Q12: For a D-SIB that is a subsidiary of a foreign G-SIB and/or a foreign D-SIB, does the industry agree that the HKMA should assess whether some degree of reliance may be placed on the “group” HLA requirement in determining the level of the local HLA requirement?

Q13: If a foreign bank branch were to be designated as a D-SIB in Hong Kong, are there any other factors that the HKMA should take into account in addition to the various “home” factors described in paragraph 62 in determining the most appropriate regulatory and supervisory measures to be adopted in respect of foreign bank branches that are D-SIBs?

3.3 Supervisory approach for D-SIBs
63. In the aftermath of the global financial crisis, the FSB and the G20 Leaders have identified, as a priority, the need for more intense and effective supervision of financial institutions and particularly of SIFIs, including D-SIBs and G-SIBs. The level of supervision applied by national authorities must be commensurate with the potential destabilisation risk that such firms pose to their own domestic financial systems, as well as the broader international financial system. It follows that supervisors should focus more resources on SIFIs, applying a higher degree of supervisory intensity according to the risk a given SIFI poses.

64. The HKMA has long adopted a risk-based approach to the supervision of AIs. Under this approach, AIs have historically experienced, and will continue to be subject to, more intensive supervision proportionate to their nature, size and complexity. In this regard, the HKMA’s D-SIB assessment exercise should serve to consolidate and enhance, rather than fundamentally change, the existing risk-based approach. The HKMA will seek to use the findings from its D-SIB assessments to help fine-tune the intensity of, and tailor the strategy for, supervising individual D-SIBs in Hong Kong. Local D-SIBs should expect more intensive supervisory interaction and engagement with the HKMA, including between the HKMA and the D-SIB’s board, and risk committee members.

65. The HKMA will expect higher standards from D-SIBs in general, in terms of risk culture and risk management, corporate governance, internal controls, MIS and data aggregation capability among other things, in line with
international developments in this area, notably the on-going work of the FSB Supervisory Intensity and Effectiveness group. The HKMA will request sight of the D-SIBs’ risk appetite and risk tolerance statements on a regular basis and supplementary information such as associated metrics or management information (e.g. risk or audit reports) may be required as appropriate, to support assessment of whether the risk appetite and risk limits are adhered to at an operational level.

66. Importantly, the HKMA expects AIs generally, but in particular D-SIBs, to be proactive in cultivating a sound risk culture, and ensuring that an effective risk governance framework is in place. In this regard, the HKMA plans to request D-SIBs to undertake more regular assessments of, and report on, the effectiveness of their risk governance structure and on their risk profiles; and use these assessments and reports as a basis for discussion with the board and risk committee for the purpose of identifying any actions required to be taken towards enhancing risk governance practices.

67. The HKMA proposes, in due course, to begin a programme of review of relevant SPM modules to see if there is any need for updating in order to include further guidance for D-SIBs in terms of any higher standards or practices to be expected of them. The HKMA’s initial assessment is that significant changes may not be necessary in most cases, as SPM modules already tend to adopt a proportionate approach.

Q14: Does the industry have any views on areas where more intensive
supervision should be focused in relation to D-SIBs, with a view to reducing 
their risk of failure?
4. REDUCING THE IMPACT OF FAILURE

4.1 Recovery and resolution planning

68. Ensuring that (at a minimum) systemically important institutions are resolvable in an orderly manner without taxpayer support is one of the key pillars of the FSB reform package for addressing the negative externalities posed by these institutions as discussed in paragraph 2. In this regard, the HKMA is developing a local recovery and resolution planning framework for AIs in Hong Kong. Both recovery and resolution planning are expected to be implemented in a proportionate manner in phases, with an initial focus on those AIs that are more systemically important or critical to financial stability in Hong Kong.

69. The HKMA intends to use the findings from the D-SIB assessment exercise described in this consultation paper to help inform the timing and pace of the phasing-in of recovery and resolution planning requirements locally. AIs designated as D-SIBs will be prioritised. It should however be noted that, whilst it is possible that an AI designated as a D-SIB might migrate out of this status if its systemic importance were to decline in future, AIs that have once been requested to submit recovery plans to, and prepare resolution information for, the HKMA will be expected to continue to do so on an on-going basis. In other words, the relevance of the designation as a D-SIB in the context of recovery and resolution planning relates only to timing and prioritisation and
does not affect the ongoing need to produce recovery plans and provide information for resolution planning purposes.
5. **QUARTERLY DISCLOSURE REQUIREMENT FOR D-SIBS**

70. The BCBS standard on the frequency of disclosure, since the introduction of the Pillar 3 framework under Basel II, has been that "large internationally active banks and other significant banks (and their significant bank subsidiaries)" must, as far as quantitative information is concerned, disclose on a quarterly basis (regardless of the frequency of financial statement publication) key capital ratios and their components.\(^\text{12}\)

71. In a Basel III environment, the minimum quantitative disclosures would cover the three capital ratios (i.e. CET1 ratio, Tier 1 ratio and Total Capital ratio) as well as the key elements in their computation. In terms of the leverage ratio, the disclosure would cover (as specified in the Basel III leverage ratio framework and disclosure requirements text released by the BCBS in January 2014) the leverage ratio, as well as its numerator (Tier 1 capital) and denominator (exposure measure).

72. As the industry is aware, the disclosure framework in Hong Kong as currently set out in the BDR does not impose quarterly disclosure requirements. In the light of the increasing emphasis on disclosure to promote market discipline, the HKMA is considering the need to align the BDR with the minimum BCBS standards. Although there is not as such a common definition for the "other significant banks" referred to in the Basel II text, it would appear appropriate in the context of the above methodology for identifying D-SIBs that, these AIs

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could fairly be described as “significant banks” and should hence be subject to quarterly disclosure requirements. As AIs should largely already have figures for the minimum quantitative disclosures in the course of their on-going monitoring of regulatory compliance, the HKMA does not envisage that D-SIBs should encounter any significant difficulty in complying with the quarterly disclosure requirement. In terms of the timing for implementation, the intention would be for the first quarterly disclosures to reflect the position of end-June 2015.

Q15: Given that the Basel standard seeks quarterly disclosure of key metrics of “significant banks”, would the industry agree that AIs designated as D-SIBs may fairly be considered as “significant banks” and should therefore be subject to quarterly disclosure of key metrics?
6. IMPLEMENTATION OF THE G-SIB FRAMEWORK IN HONG KONG

73. As mentioned in paragraph 50, in order to cater for the future eventuality of any local banking group becoming a G-SIB, the HKMA intends to amend the BCR to enable the HKMA to designate an AI as a G-SIB, on the basis of the assessment methodology in the BCBS G-SIB framework, and to impose the relevant G-SIB HLA requirements on any AI so designated.

74. Supplementary guidance will be included in the SPM module on systemically important banks to explain the HKMA’s approach to applying the BCBS methodology for the purpose of assessing the global systemic importance of an AI.

75. AIs exceeding the size threshold set by the BCBS in its G-SIB assessment methodology together with (i) any AIs which (although below this threshold) the HKMA, in the exercise of its supervisory judgement, considers should be added to the reporting group, and (ii) any AIs which were classified as G-SIBs in the previous year, will be required to report data on the twelve G-SIB indicators to the HKMA, using the template and reporting instructions devised by the BCBS.\textsuperscript{13} In parallel with the BCBS’s annual assessment, the HKMA will conduct its own G-SIB assessment applying the BCBS assessment process to relevant AIs as appropriate.

\textsuperscript{13} The template and reporting instructions can be found at: \url{www.bis.org/bcbs/gsib/}. 

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76. Given the two processes will use identical data, methodology and parameters, the outcome of the parallel assessment exercises should be consistent. In the unlikely event that the results of the local and global process should differ the HKMA would liaise with the BCBS with a view to identifying the source of the difference and rectifying the matter. The BCBS G-SIB framework also allows for the designation of banks as G-SIBs on the basis of supervisory judgement. If the HKMA were to consider that an AI, which would not otherwise be assessed to be a G-SIB by the application of the BCBS methodology, should in fact be designated as a G-SIB the HKMA will propose the addition to the BCBS and provide the HKMA’s supporting justification for consideration by the BCBS and the FSB.

77. Ultimately, the HKMA envisages that any designation by the HKMA of an AI as a G-SIB will be in line with the inclusion of that AI on the list of G-SIBs published annually by the FSB and prepared on the basis of the assessment methodology in the BCBS G-SIB framework.

78. AIs meeting the BCBS reporting threshold referred to in paragraph 75 are also subject to public disclosure requirements under the G-SIB framework. Under the G-SIB disclosure requirements, all banks meeting the threshold should be required by national authorities to ensure that figures in relation to the 12 indicators used in the assessment methodology are made publicly available. To this end, the HKMA will amend the BDR requiring relevant AIs to make the required disclosure no later than four months after the financial year-end and, in any case, no later than end-July. According to the G-SIB framework,
disclosure will be required either to be included in the institutions’ published financial statements or, at a minimum, these statements must provide a direct link to the disclosures on the institutions’ websites or in publicly available regulatory reports.

79. HLA requirements will be applied to any AIs that are designated as G-SIBs in a manner commensurate with their degree of systemic importance. The HKMA will amend the BCRs to prescribe a G-SIB HLA range of 1 – 3.5% of risk weighted assets in line with the BCBS G-SIB framework. In accordance with the HKMA’s usual practice, and as required by section 97C of the Banking Ordinance, the industry will be consulted upon the proposed amendments to the BCRs in due course.

Q16: Does the industry have any comments regarding the local implementation of the G-SIB framework in Hong Kong?
7. IMPLEMENTATION AND PHASE-IN ARRANGEMENTS

80. The HKMA will continue to refine its D-SIB assessment methodology over the next few months based on the proposals made in this consultation paper and the feedback received from the industry. The HKMA plans to conduct a formal D-SIB identification exercise in the course of 2014 based on end-2013 data, and would propose to advise relevant AIs (i.e., those to be designated as D-SIBs) of the outcome of the D-SIB identification exercise in Q4 2014, coinciding with the timeframe for the annual G-SIB update exercise.

81. As the FSB annually publishes a list of G-SIBs, the question naturally arises as to whether a public announcement should be made of the designation of D-SIBs in Hong Kong. It would seem advantageous to announce the list of D-SIBs publicly for the sake of transparency, which should help facilitate international co-ordination and implementation of the SIFI frameworks. Nationally, a number of jurisdictions including Australia, Canada, Sweden and the US have announced the list of their D-SIBs or D-SIFIs. In addition, it should be noted that the HKMA’s standard capital disclosure template for the purposes of making disclosures on the composition of an AI’s capital base under the BDR (which follows the format of the template devised by the BCBS) requires locally incorporated AIs to disclose their institution specific G-SIB or D-SIB buffer requirement. This will effectively indicate publicly which AIs have been designated as G-SIBs or D-SIBs.
82. In parallel with the phase-in of the Basel III capital conservation and countercyclical buffers, the HKMA intends to phase-in the D-SIB HLA requirement between 1 January 2016 and the end of 2018, so it becomes fully effective on 1 January 2019. The year-by-year transitional timetable is summarised in table 4 below.

Table 4: Transitional arrangement for the phasing-in of the HLA requirement

<table>
<thead>
<tr>
<th>From 1 Jan.</th>
<th>HLA requirement that should be maintained by a D-SIB</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>25% of the HLA requirement applied to D-SIBs designated in 2014</td>
</tr>
<tr>
<td>2017</td>
<td>50% of the HLA requirement applied to D-SIBs designated in 2015</td>
</tr>
<tr>
<td>2018</td>
<td>75% of the HLA requirement applied to D-SIBs designated in 2016</td>
</tr>
<tr>
<td>2019</td>
<td>100% of the HLA requirement applied to D-SIBs designated in 2017</td>
</tr>
</tbody>
</table>

83. In terms of the other requirements applicable to an AI designated as a D-SIB, the HKMA will follow up with relevant AIs bi-laterally to agree a timetable for implementing recovery and resolution planning, and to communicate and discuss the supervisory interaction which they can expect from the HKMA (e.g. in terms of the frequency of meetings with the board and its risk committee members).

84. The systemic importance of AIs may evolve over time; AIs may migrate in and out of D-SIB status, or move between “buckets” or categories of systemic
importance. Indeed, one of the policy objectives of the D-SIB framework is to give appropriate incentives for D-SIBs to become less systemic. The HKMA therefore proposes to assess the list of D-SIBs at least annually based on preceding year-end data, to ensure there are continued incentives for AIs to reduce the systemic risks they pose to the system.\textsuperscript{14}

85. In line with the G-SIB framework, the HKMA intends to conduct a review of the methodology, including the indicators used, the approach for incorporating these indicators into the assessment and identification process, the calibration of scores and the cut-off threshold/score for D-SIBs at least every three years. This should enable the HKMA to capture developments within the banking sector, and to reflect evolving international practices in the methods and approaches for measuring systemic importance.

\begin{tabular}{|p{\textwidth}|}
\hline
Q17: Does the industry agree that the outcome of the D-SIB identification exercise should be announced publicly by the HKMA? \\
Q18: Does the industry have any comments on the proposed frequency for periodic review of the D-SIB assessment methodology? \\
\hline
\end{tabular}

\textsuperscript{14} The HKMA may also update the D-SIBs list outside of the annual cycle if there are important structural changes within the banking system, e.g. a merger or a substantial take-over.
Annex: Summary of BCBS/FSB policy proposals where more stringent or prioritised application for D-SIBs had been suggested.

<table>
<thead>
<tr>
<th>Policy Measure</th>
<th>Description</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Higher Loss Absorbency (HLA)</td>
<td>The HLA requirement should be met by CET1. The level of HLA calibrated for D-SIBs should be informed by quantitative methodologies (where available) and country specific factors without prejudice to the use of supervisory judgment.</td>
<td><em>Dealing with domestic systemically important banks: framework issued by the BCBS</em>, October 2012</td>
</tr>
<tr>
<td>Recovery and Resolution Planning</td>
<td>Jurisdictions should put in place an ongoing process for recovery and resolution planning covering, at a minimum, domestically incorporated firms that could be systemically significant or critical if they fail. (Key Attribute 11.1)</td>
<td><em>Key Attributes of Effective Resolution Regimes for Financial Institutions</em>, November 2011</td>
</tr>
<tr>
<td>Strengthening Supervision</td>
<td>More intensive and effective supervision of all SIFIs, including through stronger supervisory mandates, resources and powers, and higher supervisory expectations for risk management functions, data aggregation capabilities, risk governance and internal controls.</td>
<td><em>Increasing the Intensity and Effectiveness of SIFI Supervision</em>, FSB progress report, November 2012</td>
</tr>
<tr>
<td>Common Data Template, from the principles for effective risk data aggregation and risk reporting</td>
<td>A common data template for G-SIFIs in order to address key information gaps identified during the crisis. The BCBS “strongly suggests” that national supervisors also apply these Principles to banks identified as D-SIBs by their national supervisors three years after their designation as D-SIBs.</td>
<td><em>Principles for effective risk data aggregation and risk reporting</em>, FSB, January 2013</td>
</tr>
<tr>
<td>Large exposures</td>
<td>A tighter limit for large exposures between G-SIBs was proposed in the consultation document issued by the BCBS in March 2013. In addition, the consultation paper explicitly stated that member countries could set more stringent standards and encouraged them to consider the application of stricter limits to exposures to D-SIBs or to exposures of smaller banks to G-SIBs.</td>
<td><em>Supervisory framework for measuring and controlling large exposures</em>, BCBS, March 2013</td>
</tr>
</tbody>
</table>