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12 July 2013

By email & by post

Mr Benjamin Hung  
Chairman  
The Hong Kong Association of Banks  
Room 525, 5<sup>th</sup> Floor  
Prince's Building, Central  
Hong Kong

Dear Mr Hung,

**Consultation on local implementation of Basel III liquidity standards**

I am writing to seek the Association's views on the enclosed Consultation Paper relating to the implementation of the Basel III Liquidity Standards in Hong Kong (L3). Two earlier Consultation Papers were issued to the industry in January (L1) and June (L2) 2012 respectively on the same subject.

The policy proposals and options set out in the enclosed Consultation Paper reflect the HKMA's response to the revisions to the Liquidity Coverage Ratio (LCR) published by the Basel Committee on Banking Supervision (BCBS) in January 2013 (the January 2013 LCR Revision)<sup>1</sup>, and some refinements of previous proposals to take into account, where appropriate, the comments raised by the industry in response to the earlier Consultation Papers (L1 and L2).

The enclosed Consultation Paper sets out:

- proposals for modifying the classification criteria under the proposed two-tiered approach in the light of industry comments. As you may recall, under the two-tiered approach, the LCR will be applied to AIs falling

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<sup>1</sup> See *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (<http://www.bis.org/publ/bcbs238.pdf>).

within Category 1, whilst the Modified Liquidity Ratio (MLR), a modified version of the existing Liquidity Ratio (LR) will be applied to Category 2 AIs. Further elaboration is also provided on the application of the LCR and the MLR to the Hong Kong branches of foreign banks;

- a possible timetable for implementing the LCR and the MLR, including considerations underlying any potential adoption of a phase-in arrangement for the LCR;
- proposals on whether, and to what extent, Level 2B assets should be allowed to be recognised as “high quality liquid assets” (HQLA) in Hong Kong having regard to the characteristics of local markets, and the potential implications for the definition of “liquefiable assets” under the MLR;
- the HKMA’s current thinking on the adoption in Hong Kong of the “Alternative Liquidity Approaches” offered by the BCBS (to jurisdictions with insufficient supply of local currency denominated HQLA), taking into account the framework stipulated in the January 2013 LCR Revision as well as local circumstances;
- the proposed treatment for cash-flow items under the LCR, including those items specified by the BCBS in the January 2013 LCR Revision as being subject to national discretion, together with guidance on some definitional issues; and
- the proposed modifications to the LR to create the MLR (including some further refinements to align with similar changes contemplated under the LCR), together with some policy options regarding the treatment of interbank placements to address earlier industry comments in this regard.

Our primary objective is to implement a robust liquidity regime in Hong Kong that aligns with international standards, reinforces banking stability and caters for local circumstances. Consistent with this, we have maintained a dialogue with different industry groups in the course of formulating the proposals contained in L3 and will continue to engage with the industry as we work to finalise the proposals during the remainder of this year. We therefore welcome the Association’s comments on the contents of the enclosed Consultation Paper as well as any related ideas or suggestions in the context of the local regulatory framework for liquidity.

I would be grateful if you would circulate this letter and the enclosed Consultation Paper to all members of the Association. We would appreciate it if comments from the Association could reach us by 12 September 2013. If the Association (or its Basel Implementation Committee), or any of its members, wish to discuss the proposals presented in this Paper with the HKMA, we would be pleased to arrange meetings for this purpose.

If you have any questions on the enclosed Consultation Paper, please feel free to contact Ms Rita Yeung (2878-1388) or Mr Thomas Wong (2878-1219).

I am writing in similar terms to The DTC Association.

Yours sincerely,

Karen Kemp  
Executive Director (Banking Policy)

Encl.

c.c. Financial Services and the Treasury Bureau  
(Attention: Mr Jackie Liu)