

 HONG KONG MONETARY AUTHORITY 香港金融管理局		
Supervisory Policy Manual		
CR-L-4	Underwriting of Securities: Banking (Exposure Limits) Rules	V.2 – Consultation

This module should be read in conjunction with the [Introduction](#) and with the [Glossary](#), which contains an explanation of abbreviations and other terms used in this Manual. If reading on-line, click on blue underlined headings to activate hyperlinks to the relevant module.

Purpose

To explain the MA's policy towards the underwriting and sub-underwriting of securities by AIs in relation to Parts 2, 3 and 7 of the Banking (Exposure Limits) Rules

Classification

A statutory guideline issued by the MA under the Banking Ordinance, §7(3)

Previous guidelines superseded

Guideline 5.2.4 "Underwriting of Securities: §§81 and 87" dated 13.10.91;
CR-L-4 v.1 "Underwriting of Securities: §§81 and 87" dated 31.08.01

Application

To all locally incorporated AIs

Structure

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 - 4.1 Notification
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1. Statutory position

1.1 Limit on exposure to single counterparty and group of linked counterparties

1.1.1 Part 7 of the Banking (Exposure Limits) Rules (BELR) limits a locally incorporated AI's aggregate exposures to a single counterparty or group of linked counterparties to 25% of its Tier 1 capital. Aggregate exposures include the value of an AI's holdings of shares, debentures and other debt securities issued by these parties (see subsection 2.3 of [CR-G-8](#) "Large Exposures and Risk Concentrations").

1.1.2 Among the exemptions available under the BELR, Rule 48(1)(f) provides that any exposures arising from any share capital or debt securities acquired under an underwriting or sub-underwriting contract can be excluded, for up to seven working days, from calculation of an AI's exposure for the purposes of the 25% limit. The MA may give written approval for longer periods and, if the MA thinks proper, attach conditions to such approval.

1.2 Limit on equity exposure



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1.2.1 Part 2 of the BELR provides that a locally incorporated AI's aggregate equity exposure should not exceed 25% of its Tier 1 capital.

1.2.2 An exemption from the equity exposure limit similar to Rule 48(1)(f) of the BELR is available under Rule 14(1)(c) of the BELR.

1.3 Limit on acquisition of share capital of company

1.3.1 Part 3 of the BELR provides that a locally incorporated AI must not, except with a consent given by the MA, acquire all or part of the share capital of a company to a value equivalent to 5% or more of the AI's Tier 1 capital at the time of the acquisition.

1.3.2 An exemption from calculation towards the 5% limit similar to that of Rule 48(1)(f) of the BELR is available under Rule 23(2)(a)(ii) of the BELR.

1.4 Seven day exemption period

1.4.1 The seven day exemption period available under Rules 14, 23 and 48 of the BELR runs from the time when an AI acquires the shares being underwritten.

1.4.2 The main reasons for the short exemption period are to make the HKMA aware of an exposure at an early stage and to deter AIs from taking on too large underwriting commitments with which they may not have the necessary experience, skills and systems in place to deal.

1.4.3 The MA has discretion to approve a longer exemption period beyond seven working days, and may attach conditions to such approval.

2. Supervisory approach

2.1 Rationale

2.1.1 The HKMA needs to be satisfied with the nature and scale of any prospective underwriting transactions before an AI enters into a commitment. It does so by adopting the policy set out in this module. This seeks to avoid the situation in which an AI is left with an imprudently large exposure at the



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end of the seven day exemption period in circumstances where the MA is not content to extend the exemption period.

2.2 Coverage

- 2.2.1 The HKMA's policy covers underwriting and sub-underwriting commitments in respect of new securities and further issues of existing securities, where the AI will only be called upon to purchase the securities if end-investors fail to do so.
- 2.2.2 In relation to an AI acting as an arranger, agent or similar role in the issuance of securities, this module is also applicable to the AI's implicit commitment to acquire the securities when end-investors fail to do so. An implicit commitment is deemed to exist when, as a matter of policy or practice, the AI generally acquires the securities when end-investors fail to do so. This implicit commitment is typically for preserving the reputation of the AI, which makes the AI feel compelled to acquire the securities beyond its contractual obligation.
- 2.2.3 It does not cover "bought deals" where the AI acquires the securities from the outset as a principal for subsequent sale in the market or "block trades" in the secondary market. Holdings of securities in these circumstances will form part of an exposure covered by Part 7 of the BELR and if the securities in question are shares, an equity exposure under Part 2 and share acquisition under Part 3 of the BELR.

3. Prior consultation on underwriting activity

3.1 Underwriting policy

- 3.1.1 Any AI wishing to engage in underwriting activity¹ should first agree its plans with the HKMA.
- 3.1.2 This will require the AI to prepare an underwriting policy, agree it with the HKMA and have it finally approved by its Board of Directors. The policy will need to contain, inter

¹ This includes activities of arranger and agent etc bearing implicit commitment to acquire the shares as mentioned in paragraph 2.2.2.



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alia;

- approved types of underwriting transactions;
- individual and aggregate limits applying to underwriting commitments. Such limits should also take account of cases where the AI has other financial exposures to the counterparty concerned;
- where no such limits are in place but transactions are to be approved case by case, clear instructions about the type and size of transactions which will be contemplated;
- arrangements applying to the sub-underwriting of commitments taken on by the AI, including the degree of commitment which should be obtained from the sub-underwriter; and
- arrangements for the disposal of securities acquired under an underwriting contract, in particular to avoid a financial exposure exceeding 25% of Tier 1 capital after the exemption period.

3.2 Maximum permitted commitments

- 3.2.1 The HKMA will agree with an AI in advance the maximum size and type of underwriting and sub-underwriting transactions, measured on an aggregate basis per issuer, that it can take on. AIs may also establish limits for different categories of issuers, e.g. according to their credit ratings.
- 3.2.2 The limits will apply to the maximum amount of securities an AI is committed to taking up, i.e. after deduction of amounts to be sub-underwritten by other parties under firm and binding agreements.
- 3.2.3 In considering the limits proposed by an AI, the HKMA will take account of the following factors:
- the AI's underwriting policy;
 - types of securities to be underwritten - for example, the limits should reflect the relative risks of different types of securities and issuers (with reference to their credit ratings where applicable);



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- the AI's underwriting expertise and previous experience and track record (e.g. whether it has been “stuck” with any issues);
 - the AI's market standing, placing network, etc; and
 - risk control systems in place.
- 3.2.4 Prior consultation with the HKMA will be necessary, however, where the AI already has a financial exposure to the issuer concerned, including in respect of other underwriting commitments. The maximum allowable size of an underwriting transaction may need to be reduced to take account of this exposure.

4. Notification and other requirements

4.1 Notification

- 4.1.1 Depending on the size of the limits agreed, the HKMA may set a notification threshold below the maximum limit, so that it is made aware of significant commitments being undertaken.

4.2 Requests for extension of exemption period

- 4.2.1 Where an AI applies for the MA's approval to hold securities beyond the seven day exemption period, the MA may give such approval for a period of up to three months, provided that the underwriting commitment falls within a previously agreed limit as mentioned in subsection 3.2.
- 4.2.2 A further extension of the exemption period, however, will only be granted in special circumstances.

4.3 Commitment in excess of previously agreed limit

- 4.3.1 Where a proposed transaction would exceed a previously agreed limit, the AI should seek the prior approval of the HKMA.



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