



Supervisory Policy Manual

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Large Exposures and Risk Concentrations

V. 2 – 01.04.04

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 set out the minimum standards and requirements that AIs are expected to follow, and to describe how the HKMA proposes to exercise its supervisory powers, in relation to controls on large exposures and risk concentrations

Classification

A statutory guideline issued by the MA under the Banking Ordinance, §16(10)

Previous guidelines superseded

Guideline 5.3 “Specification of Factors for Off-balance Sheet Exposures under Section 81(3) of the Banking Ordinance” dated 04.10.91

Application

To all locally incorporated AIs

For AIs incorporated outside Hong Kong, the overall supervision of large exposures and risk concentrations is expected to be the responsibility of their home regulatory authorities. They are, however, required to report the large exposures of their Hong Kong operation to the HKMA in the “Return of Large Exposures - MA(BS)1D” and certify compliance with Part XV of the Banking Ordinance, in respect of those provisions applicable to them¹, in the “Certificate of Compliance - MA(BS)1F(b)”.

¹ Under Part XV of the Banking Ordinance, §§80, 82, 85, 86 and 91 are applicable to the Hong Kong operation of AIs incorporated outside Hong Kong.



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1. Introduction

1.1 Background

- 1.1.1 The minimum authorization criterion under para. 8 of the Seventh Schedule to the Banking Ordinance provides that the MA should be satisfied that an AI complies with the provisions of Part XV of the Banking Ordinance, which set out the limitations on exposures and risk concentrations of AIs.
- 1.1.2 Moreover, under para. 12 of the Seventh Schedule, the MA should be satisfied that the business of an AI is carried out with integrity, prudence and the appropriate degree of professional competence and in a manner which is not detrimental to the interests of depositors or potential depositors. Whether an AI has the proper control systems to manage its large exposures and guard against concentration risks is one of the factors that the MA will take into account in assessing the compliance with this minimum authorization criterion.
- 1.1.3 Failure to adhere to the standards and requirements in this module may indicate that an AI does not have adequate systems to control its risk concentrations and carry out its business in a prudent manner. This may call into question whether the AI continues to satisfy the above-mentioned minimum authorization criteria under the Seventh Schedule to the Banking Ordinance.
- 1.1.4 Non-compliance with this module may also constitute a ground for the MA to impose a higher minimum capital adequacy ratio on the AI under §101 of the Banking Ordinance to lessen any additional risk from the concentration.
- 1.1.5 For the purpose of this module, any exposure to a counterparty or a group of related counterparties which is greater than or equal to 10% of an AI's capital base is regarded as a large exposure.

1.2 Forms of risk concentration

- 1.2.1 Risk concentration can be viewed as any exposure with the potential to produce losses that are substantial enough to threaten an AI's capital strength or earnings or



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otherwise undermine public confidence in the AI. It can take many forms, including exposures to particular types of asset (e.g. interest in land or shares), individual counterparties, groups of related counterparties and counterparties in specific geographical locations, economic or industry sectors.

- 1.2.2 Risk concentration may also arise from subtler or more situation-specific factors. For example, the financial problems in a particular industry or country may have a contagion effect on other industries or countries that have a close economic linkage with it.

1.3 Rationale for controlling risk concentrations

- 1.3.1 Diversification of risk is essential in banking. Many past bank failures have been due to risk concentrations of some kind. It is essential for AIs to prevent undue risk concentrations from excessive exposures to particular counterparties, industries, economic sectors, countries or regions.

- 1.3.2 While concentration risks are inherent in banking and cannot be totally eliminated, they can be limited and reduced by adopting proper risk control and diversification strategies. Safeguarding against risk concentrations should form an important component of an AI's risk management systems.

2. Statutory limitations on exposures and risk concentrations

2.1 General

- 2.1.1 This module covers mainly §§81, 87 and 88 in Part XV of the Banking Ordinance, which are relevant to locally incorporated AIs for the control of exposures and risk concentrations². They relate to:

- limitations on exposures to a person or a group of related persons (§81);

² AIs should refer to §85 of the Banking Ordinance, which sets out the limitations on advances to employees.



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- limitation on holding of shares (§87); and
 - limitation on holding of interest in land (§88).
- 2.1.2 Other relevant sections, which deal with limitations on exposures to connected parties (§83) and acquisition by AIs incorporated in Hong Kong of share capital in companies (§87A), are covered under [CR-G-9](#) “Connected Lending” and [CR-L-5](#) “Major Acquisitions and Investments: §87A” respectively.
- 2.1.3 Subsections 2.2 to 2.6 below provide a summary of the key provisions contained in §§81, 87 and 88. They also endeavour to interpret these subsections in simplified language but readers are reminded that in case of any conflict the definitions and provisions in the Banking Ordinance prevail. In the case of doubt, AIs should consult with the HKMA or seek relevant legal advice.

2.2 Summary of relevant sections in Part XV

- 2.2.1 Under §81(1) of the Banking Ordinance, an AI is subject to a statutory limit of 25% of its capital base on its financial exposure to any one person or group of related persons. Various exemptions from this limitation are available or apply under §81(4), (4A), (5) and (6) (see subsections 2.4 and 2.5 below for details).
- 2.2.2 Apart from the §81 limitation on financial exposure, an AI should not hold any share capital of a company or companies to an aggregate value in excess of 25% of its capital base under §87(1). This 25% limit applies similarly under §88(1) to an AI’s holding of interests in land.
- 2.2.3 If the holding of interests in land is, in the opinion of the MA, necessary for conducting the AI’s business or providing housing or amenities for its staff, such holding may be excluded from the §88(1) limit under §88(2). Nevertheless an AI’s holding of interests in land under §88(2) needs to be aggregated for the purpose of calculating the exposure under §90(1) (see para. 2.2.5 below).



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- 2.2.4 Other exemptions from the limits in §§87 and 88 are available under §§87(1), 87(2) and 88(5) (see subsection 2.6 for details).
- 2.2.5 An AI is required under §90(1) to limit its aggregate exposures under §§83, 87 and 88(1) and (2) to within 80% of its capital base. Unless the MA otherwise specifies, the aggregate exposures under §90(1) should exclude transactions exempted under §§83(4A), 87(1), 87(2) and 88(5).
- 2.2.6 §79A empowers the MA to require AIs to comply with the above statutory limits under Part XV on a consolidated basis or on both a solo and consolidated basis (see [CR-L-1](#) “Consolidated Supervision of Concentration Risks under Part XV: §79A” for more guidance). The MA has the discretion to decide which subsidiaries of an AI are to be included in the consolidation. Generally, consolidation for the purposes of §79A will include subsidiaries that undertake financial business and those which incur risks regulated by Part XV (e.g. insurance subsidiaries or property holding subsidiaries).
- 2.2.7 Under §79(2), the term “capital base” for the purposes of Part XV refers to the capital base of an AI that is calculated in accordance with the Third Schedule to the Banking Ordinance but subject to the basis of consolidation required under §79A. The subsidiaries consolidated for Part XV purposes may differ from those included for the purpose of calculation of the capital adequacy ratio under §98(2).
- 2.2.8 The MA may require an AI to provide evidence or information to prove that it complies with the statutory limits under Part XV.

2.3 Definition of financial exposure under §81(2)

- 2.3.1 Under §81(2) of the Banking Ordinance, the financial exposure of an AI to a person or a group of related persons (see subsection 2.4 below for the definition of “person”) is the aggregate of:
- all advances, loans and credit facilities (including letters of credit) given to that person or group of related persons;



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- the value of its holdings of shares and debentures (within the meaning of those terms in §2 of the Companies Ordinance³) and other debt securities issued by that person or group of related persons;
- financial exposure (declared by the MA under §81(2A) to be financial exposure) of the AI to that person or group of related persons; and
- the principal amount, multiplied by the factor specified by the MA under §81(3) for off-balance sheet items in Table B of the Third Schedule, where the counterparty is that person or group of related persons.

2.3.2 The following table sets out the list of off-balance sheet items specified by the MA under §81(3) for inclusion in the calculation of the financial exposure. All of them carry a 100% credit conversion factor (CCF).

Item	Nature
Direct credit substitutes	Irrevocable off-balance sheet obligations which carry the same credit risk as a direct extension of credit. These include: <ul style="list-style-type: none"> • guarantees; • confirmed letters of credit; • standby letters of credit serving as financial guarantees for loans; and • securities and acceptances (including endorsements with the character of acceptances) other than acceptances included in trade-related contingencies.
Transaction-related contingencies	Contingent liabilities which involve an irrevocable obligation of the AI to pay a beneficiary when a customer fails to perform some contractual, non-financial obligation. They include:

³ “Debenture” includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not. “Share” means share in the share capital of a company and includes stock, except where a distinction between stock and shares is expressed or implied.



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Item	Nature
	<ul style="list-style-type: none"> • performance bonds; • bid bonds; • warranties; and • standby letters of credit related to a particular transaction.
Trade-related contingencies	<p>Contingent liabilities which relate to trade-related obligations. They include:</p> <ul style="list-style-type: none"> • letters of credit; • acceptances of trade bills; • shipping guarantees; and • any other trade-related contingencies.
Sale and repurchase agreements	<p>Arrangements whereby the AI sells a loan, security or other asset to another person with a commitment to repurchase the asset at an agreed price on an agreed future date.</p>
Assets sales or other transactions with recourse	<p>Assets sales where the holder of the asset is entitled to put the asset back to the AI within an agreed period or if the value or credit quality of the asset deteriorates.</p>
Forward asset purchases	<p>Commitments to purchase a loan, security or other asset, including under a put option granted by the AI to another party, at a specified future date on pre-arranged terms.</p>
Partly paid-up shares and securities (held by the AI)	<p>The unpaid portion of paid-up shares or securities which the issuer may call for at a future date.</p>
Forward forward deposit placed	<p>Any agreement between the AI and another party whereby the AI will place a deposit at an agreed rate of interest with that party at some pre-determined future date.</p>
Note issuance and revolving underwriting facilities	<p>Arrangements whereby a borrower may draw down funds up to a prescribed limit over a pre-defined period by making repeated note issues to the market and where, should the issue prove unable to be placed in the market, the unplaced amount is to be taken up or funds made</p>



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Item	Nature
	available by the underwriter of the facility.
Other commitments	Other commitments with: <ul style="list-style-type: none"> • an original maturity of under 1 year or which may be cancelled unconditionally at any time by the AI or • an original maturity of 1 year or over.

2.3.3 Als should note that the CCF specified under §81(3) for some off-balance sheet items listed above is higher than that specified for the same item in the Third Schedule to the Banking Ordinance. In particular, transaction-related contingencies, trade-related contingencies, note issuance and revolving underwriting facilities and other commitments carry a lower CCF of 20% or 50%, as the case may be, under the Third Schedule.

2.4 Definition of person under §81

2.4.1 A person comprises both natural and legal persons. For the purpose of §81 of the Banking Ordinance, the term “person” includes any partnership, any public body and any body of persons, corporate or unincorporate.

2.4.2 §81(1) applies to any single person or group of related persons as follows:

- §81(1)(a) - any one person;
- §81(1)(b)(i) - two or more companies which are subsidiaries of the same holding company;
- §81(1)(b)(ii) - two or more companies which have the same controller (not being a company);
- §81(1)(c) - any holding company and one or more of its subsidiaries; or
- §81(1)(d) - any one person (not being a company) and one or more companies of which that person is a controller.

2.4.3 By virtue of §81(4) and (4A), exemptions from the application of §81(1) are available to certain persons.



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- 2.4.4 Under §81(4), the MA may exempt a subsidiary, a holding company of an AI or a subsidiary of such holding company for the purpose of §81(1).
- 2.4.5 §81(4A) provides a blanket exemption to AIs from aggregating their exposures to HKSARG-owned entities⁴ for the calculation of financial exposure under §81(1). AIs are, however, obliged to ensure that their exposure to each of these individual entities is within 25% of their capital base unless the entity concerned is otherwise exempted.
- 2.4.6 Under §81(5), the MA may specify a limit higher than the 25% limit for an AI's financial exposure to a trustee in respect of two or more trusts.

2.5 Exempt exposures under §81(6)

2.5.1 Under §81(6) of the Banking Ordinance, the financial exposure of an AI is exempted from the application of §81(1) if such exposure falls within the following categories:

- exposure to other AIs;
- exposure to an overseas incorporated bank which is not an AI where it is, in the opinion of the MA, adequately supervised by the relevant banking supervisory authority;
- exposure to the extent to which it is secured by a cash deposit, a guarantee, an undertaking which is similar to a guarantee, or securities issued, or guaranteed, by the central government or the central bank of any Tier 1 country within the meaning of the Third Schedule and such collateral or guarantee is accepted by the MA. The general criteria that the MA will apply in assessing whether such collateral or guarantee is acceptable are set out in [CR-L-2](#) "Exemption of Financial Exposures: §81(6)(b)(i)";

⁴ These entities include entities owned or controlled by the HKSARG or the Financial Secretary Incorporated in trust for the HKSARG.



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- exposure to the extent to which it is covered by a letter of comfort accepted by the MA. See [CR-L-3](#) “Letters of Comfort: §81(6)(b)(ii)” for the criteria that the MA will apply in assessing whether such letters of comfort are acceptable;
- exposure acquired by the purchase of bills of exchange or documents of title to goods where the holder of such bills or documents is entitled to payment outside Hong Kong for goods exported from Hong Kong;
- advances, loans and credit facilities made against the bills or documents mentioned above;
- exposure to the HKSARG or any other government acceptable to the MA;
- share capital or debt securities held as collateral for facilities granted or acquired by the AI during debt recovery. In the latter case, the AI should, however, dispose of such collateral at the earliest possible opportunity, and in any case within 18 months after the acquisition or within such further period as may be approved by the MA;
- an indemnity issued by the AI to a person to protect that person from any damages which may be incurred as a result of the person registering a transfer of shares (e.g. lost share certificates), provided that certain specified conditions are met;
- exposure acquired under an underwriting or sub-underwriting contract. If the exposure is an on-balance sheet item, the exemption will only last for a period not exceeding seven working days or such further period as may be approved by the MA⁵;
- exposure to a multilateral development bank⁶;

⁵ See [CR-L-4](#) “Underwriting of Securities: §§81 and 87” for the MA’s policy on extending the exemption period for the underwriting or sub-underwriting of securities.

⁶ Under the Third Schedule to the Banking Ordinance, the term “multinational development bank” means the International Bank for Reconstruction and Development, the Inter-



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- exposure to the Housing Authority arising from guarantees given to AIs under the Home Ownership or Private Sector Participation Scheme;
- exposure to The Hong Kong Mortgage Corporation Limited (HKMC) arising from its obligations under the Mortgage Insurance Programme;
- exposure to the extent that it has been written off or specifically provided for in the books of the AI; and
- exposure to the HKMC or any company that issues mortgage-backed securities in connection with the HKMC's Guaranteed Mortgage-Backed Pass-Through Securitisation Programme, if the exposure to the HKMC or the company arises from the obligations placed upon it for the purposes of the Programme.

2.6 Exempt exposures under §§87 and 88

2.6.1 The MA may grant exemption from §87(1) under §87(2) in the following circumstances:

- where the holding of share capital is under an underwriting or sub-underwriting contract for a period not exceeding seven working days (or such further period as may be approved by the MA⁵);
- to any holding of share capital in another AI or a company carrying out nominee, executor or trustee functions, or other functions related to banking, deposit-taking or insurance business, investments or other financial services; or
- to any holding of share capital which is deducted from the AI's capital base.

American Development Bank, the Inter-American Investment Corporation, the Asian Development Bank, the African Development Bank, the European Investment Bank, the Nordic Investment Bank, the Caribbean Development Bank, the European Bank for Reconstruction and Development or the International Finance Corporation.



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2.6.2 Share capital or interests in land held as collateral for facilities granted or acquired by an AI during debt recovery are also exempted under §§87(1) and 88(5) from the 25% limit. In the latter case, however, such share capital or interest in land acquired should be disposed of within 18 months after its acquisition or within such further period as may be approved by the MA.

3. Prudent principles for controlling risk concentrations

- 3.1 AIs should carefully manage and avoid excessive risk concentrations of various kinds, including exposures to individual counterparties (see para. 3.3 below), groups of counterparties with similar characteristics, economic and geographical sectors, types of lending with similar characteristics (e.g. property lending, share margin financing, taxi loans) and holdings of securities or investments.
- 3.2 Statutory limits are not necessarily indicative of the level of risks an AI should take. For example, a statutory limit of 25% under §81 of the Banking Ordinance does not mean that as high a level of exposure as this is appropriate for a particular counterparty or a particular AI. AIs should establish internal exposure limits that are reasonable in relation to their capital base and balance sheet size. They should require exceptional justifications before allowing such limits to be exceeded.
- 3.3 When considering the extension of large credit facilities (in particular those exceeding 10% of an AI's capital base), AIs should exercise extra care in ensuring that prudent credit granting criteria are met. They should have a thorough understanding of the borrower's background, financial strength and repayment sources, nature of business and funding needs, as well as management capabilities. The credit decision should be supported by an in-depth credit assessment of the borrower's debt-servicing capacity based on sufficient and reliable information (see [CR-G-2](#) "Credit Approval, Review and Records" for further guidance).
- 3.4 Although certain types of exposure or exposures to certain counterparties are not subject to the 25% statutory limit under §81 of the Banking Ordinance (see subsections 2.4 to 2.6 above



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for the nature of such exemptions), this does not mean that they are totally free from credit risk. AIs should still exercise particular care to avoid undue concentration of risk in respect of any such exposure. Preferably, the exposure to exempt counterparties should each be contained within 25% of an AI's capital base.

- 3.5 AIs should avoid undue reliance on collateral or guarantees. Where collateral (or a guarantee) is taken to support a large exposure, AIs should make sure that the primary consideration is the borrower's debt-servicing capacity. §81(6)(b) allows for the reduction of financial exposure under §81(1) to the extent that the exposure is secured by eligible collateral accepted by the MA (see subsection 2.5 above for more details). AIs should however note that the reduction of financial exposure does not imply that the excess risk on the secured portion is totally eliminated.
- 3.6 As a general rule, AIs should ensure that the level of exposure to any counterparty, whether the exposure is exempt or secured, is commensurate with that counterparty's financial strength and creditworthiness.
- 3.7 AIs that have developed an internal risk rating system for credit risk management may have regard to the internal ratings assigned to individual counterparties as a basis for setting the internal exposure limits for these counterparties. The internal risk rating system in use should be commensurate with the nature, size and complexity of an AI's activities.
- 3.8 AIs should not necessarily limit the definition of a "group of related counterparties" to that described in para. 2.4.2 above. The definition should ideally capture all parties connected in such a way that the financial strength of any of them may affect that of the others, e.g., counterparties linked by cross-guarantees or whose liabilities are guaranteed by the same guarantor.
- 3.9 Apart from credit risk, it is important for AIs to ensure that other risks associated with large exposures (e.g. legal, operational and market risk) are adequately monitored and controlled. For example, there should be adequate control procedures to ensure that the AI's legal rights are properly protected and that



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the chance of operational fraud or errors is minimised. Exposures subject to market risk should be periodically revalued.

- 3.10 Where appropriate, AIs should conduct stress-testing and scenario analysis of large exposures to assess the impact of different scenarios and of the potential losses that may arise from changes in key risk factors such as economic cycles, interest rate and other market movements and liquidity conditions.

4. Prudential limits

4.1 Authority

- 4.1.1 Pursuant to para. 12 of the Seventh Schedule to the Banking Ordinance, the HKMA may set prudential limits to prevent AIs from taking excessive concentration risks that may be detrimental to the interests of depositors or potential depositors.
- 4.1.2 If an AI is, in the opinion of the HKMA, exposed to a significant level of risk concentration that may affect its financial stability, the HKMA may set prudential limits on the AI's exposures to particular counterparties, groups of counterparties, economic or geographical sectors. These limits will be determined on a case-by-case basis, having regard to the AI's individual circumstances.
- 4.1.3 The HKMA may also direct an AI to take such other measures as it deems necessary to reduce its level of risk concentration.

4.2 Clustering limit

- 4.2.1 Normally, an AI which has a “clustered” loan portfolio (i.e. a large number of sizeable single exposures) will be subject to a higher level of concentration risk than an AI with a widely diversified loan portfolio.
- 4.2.2 In this regard, every AI is expected to set an internal limit in its large exposures and risk concentrations policy (see subsection 5.2 below) to control the aggregate of its non-exempt large exposures on both a solo and consolidated basis (referred to as the clustering limit hereafter). This



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limit, expressed in terms of amount or percentage of an AI's capital base⁷, should be approved by its Board of Directors and agreed with the HKMA.

4.2.3 As a reference, most AIs in Hong Kong have an aggregate amount of non-exempt large exposures which is within 200% of their capital base. This appears to provide a reasonable benchmark for AIs to set their clustering limit. The HKMA will have regard to this level in monitoring an AI's large exposures. It is important that the limit set by AIs should be realistic and should not be set at a level so high that it could never be breached.

4.2.4 In considering whether the clustering limit set by an AI is acceptable, the HKMA will take into account the following factors:

- the level of the AI's capital adequacy ratio;
- consistency with the AI's large exposures and risk concentrations policy (see subsection 5.2 below);
- the number of exposures, their individual size and the nature of business of the borrowers concerned; and
- the characteristics of the AI, including the nature of its business and the experience of its management.

4.2.5 In determining the amount of exposures subject to the clustering limit, an AI should aggregate those exposures that are equal to or more than 10% of its capital base and not currently exempted from §81 of the Banking Ordinance⁸.

4.2.6 In the case of an exposure supported by a letter of comfort accepted by the MA under §81(6)(b)(ii), the whole amount of the exposure is excluded for the purposes of the clustering limit. The total of all exposures covered by a letter of comfort is, however,

⁷ If by reference to a consolidated capital base, the limit should be calculated as specified in §79A for the purpose of Part XV of the Banking Ordinance.

⁸ See §81 of the Banking Ordinance or subsections 2.4 and 2.5 above for a summary of the exemptions available.



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subject to an aggregate lending limit as specified by the MA. See paras. 2.4.3 and 2.5.1 of [CR-L-3](#) “Letters of Comfort: §81(6)(b)(ii)” for more details.

- 4.2.7 If a loan is guaranteed, an AI should include either its direct exposure to the borrower or its indirect exposure to the guarantor to avoid double-counting the same exposure for the purposes of the clustering limit. The selection depends on whether the direct exposure is fully guaranteed.

Example 1: Joint guarantee of full amount

Counterparty	Direct exposure	Indirect exposure	Total
A (borrower)	12%	-	12%
B (guarantor to A)	-	12%	12%
C (guarantor to A)	-	12%	12%

Counterparty to be selected = A, B or C

Amount subject to clustering limit = 12% of capital base

Example 2: Joint guarantee of less than the full amount

Counterparty	Direct exposure	Indirect exposure	Total
A (borrower)	12%	-	12%
B (guarantor to A)	-	6%	6%
C (guarantor to A)	-	6%	6%

Counterparty to be selected = A

Amount subject to clustering limit = 12% of capital base

- 4.2.8 Where an AI has an aggregate exposure, including both direct and indirect, to a counterparty which is equal to or more than 10% of its capital base, the AI should include the remaining exposure to that counterparty (after deducting the double-counted portion as required in para. 4.2.7) for the purposes of the clustering limit.

Example 3: Multiple exposures with joint guarantee

Counterparty	Direct exposure	Indirect exposure	Total
A (borrower)	12%	-	12%
B (borrower & full guarantor to A)	11%	12%	23%



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C (borrower & half guarantor to A)	5%	6%	11%
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Counterparties to be selected =

A (12%), B (11%) and C (5%); or

B (23%) and C (5%)

Amount subject to clustering limit = 28% of capital base

- 4.2.9 AIs should establish adequate systems to monitor compliance with the clustering limit agreed with the HKMA.

5. Controls over large exposures and risk concentrations

5.1 Oversight by Board of Directors

- 5.1.1 The Board of Directors should ensure that the AI fully understands its legal obligations in relation to the limitations on exposures and risk concentrations under Part XV of the Banking Ordinance.
- 5.1.2 The Board should ensure that the AI establishes a policy on the control of large exposures and risk concentrations. The policy, and any changes thereto, should be reviewed and approved by the Board.
- 5.1.3 The Board should be responsible for ensuring that the AI establishes appropriate procedures and systems to identify, measure and control large exposures and risk concentrations and to monitor compliance with the approved policy.
- 5.1.4 The Board should ensure that large exposures are approved by the appropriate level of management in the AI. Normally, the Credit Committee approves large credits to customers, e.g. those with total facilities in excess of 5% of the AI's capital base (see subsection 2.1 of [CR-G-2](#) "Credit Approval, Review and Records").
- 5.1.5 The Board should receive regular reports to facilitate its review of the AI's large exposures and risk concentrations.

5.2 Policy

- 5.2.1 The details that should be included in the large exposures and risk concentrations policy depend on the



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nature of an AI's business and its scale of operation.

5.2.2 Nevertheless, the policy should cover as a minimum the following:

- the definition of exposure. AIs do not necessarily have to limit this to the §81 definition. They should take into account the nature of their business and the complexity of their products. In any case, an AI's exposures to a counterparty should include its on- and off-balance sheet exposures and indirect exposures. Exposures arising from securities, foreign exchange, derivatives or other off-balance sheet exposures not specified in §81(3) (see subsection 2.3 above) should also be captured where appropriate;
- the criteria to be used for identifying a group of related persons;
- the individual and aggregate exposure limits for various types of counterparty (e.g. governments, banks, corporate and individual borrowers). The 25% statutory limit under §81 should not necessarily be seen as the upper limit for counterparty exposures;
- the aggregate maximum exposure limits for an industry, an economic sector, a country, a region or a group of borrowers which have a similar or homogeneous risk;
- the delegation of credit authority within the AI for approving large exposures;
- the circumstances in which the above limits can be exceeded and the party authorized to approve such excesses, e.g. the AI's Board of Directors or Credit Committee with delegated authority from the Board;
- any differentiation between the limits for secured and unsecured exposures. AIs should note however that secured exposures are not risk free;
- the clustering limit (see subsection 4.2 above), i.e. the maximum amount of aggregate non-exempt



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large exposures, in terms of amount or percentage of the AI's capital base, which may exist at any one time;

- the procedures for identifying, reviewing, monitoring and controlling large exposures; and
- the allocation of responsibility for reporting large exposures to the HKMA and for ensuring compliance with Part XV of the Banking Ordinance and other prudential obligations.

5.2.3 Where applicable, the above internal limits should be set on both a solo and a consolidated basis.

5.2.4 Every AI is required to agree its policy on large exposures and risk concentrations with the HKMA. The HKMA should be consulted prior to any changes to the policy.

5.3 Regular monitoring

5.3.1 AIs should have a central liability record (preferably based on an automated system) for each large exposure. AIs should be able to monitor such exposures against statutory and prescribed internal limits on a daily basis. See [CR-G-2](#) "Credit Approval, Review & Records" and [CR-G-3](#) "Credit Administration, Measurement and Monitoring" for further guidance.

5.3.2 Every AI should have adequate management information and reporting systems that enable management to identify risk concentrations within the asset portfolio of the AI or of the group (including subsidiaries and overseas branches) on a timely basis. If a concentration does exist, AIs should reduce it in accordance with their prescribed policies.

5.4 Independent audits and compliance

5.4.1 AIs should maintain regular and independent checks on the adequacy of controls over large exposures and on compliance with relevant internal policies and applicable laws and regulatory requirements.

5.4.2 AIs should ensure that their internal or external auditors conduct a regular review of the quality of large exposures



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and controls to safeguard against risk concentrations. Their review should ascertain whether:

- the AI's relevant policies, limits and procedures are complied with; and
- the existing policies and controls remain adequate and appropriate for the AI's business.

5.4.3 Management should take prompt corrective action to address concerns and exceptions raised.

5.4.4 There should also be an independent compliance function⁹ to ensure that all relevant internal and statutory requirements and limits (including Part XV provisions of the Banking Ordinance) are complied with. Any breaches of statutory requirements and deviations from established policies and limits should be reported to senior management, and the HKMA where appropriate, in a timely manner.

6. Notification and regulatory reporting

6.1 Notification

6.1.1 An AI should notify the HKMA immediately of any breach of the statutory limits under Part XV of the Banking Ordinance, the clustering limit or other prudential limits agreed with the HKMA.

6.2 Breaches

6.2.1 Every director and every manager¹⁰ of an AI which contravenes any section of Part XV commits an offence and is liable to penalties (e.g. fine and imprisonment) under the Banking Ordinance. The HKMA will consider whether the offence should be recommended for prosecution based on the circumstances of each case.

⁹ For AIs whose scale of business is small, the HKMA may determine on a case-by-case basis whether it is acceptable to allow their external or internal auditors or in-house lawyers to undertake the compliance function.

¹⁰ The meaning of “manager” is as defined under §2 of the Banking Ordinance.



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- 6.2.2 The breach of statutory limits under Part XV may indicate that the AI does not have adequate systems of control to ensure that the limits specified in Part XV will not be exceeded. On the other hand, the breach of prudential limits agreed with the HKMA may indicate that the AI does not carry out its business in a prudent manner. This may call into question whether the AI continues to satisfy the relevant authorization criteria under the Seventh Schedule to the Banking Ordinance (i.e. paras. 8 and 12). The HKMA will consider whether the MA's power to revoke the authorization of the AI is exercisable¹¹ and if so, whether it should be exercised.
- 6.2.3 If a breach occurs, the HKMA may consider taking other appropriate actions, e.g. increasing the AI's minimum capital adequacy ratio or limiting its business expansion. It may also require the AI to agree a timetable to bring the exposure quickly below the statutory limit or any agreed limit and to report progress on a regular basis.

6.3 Regulatory reporting

- 6.3.1 AIs are required to report to the HKMA their large exposures in the "Return of Large Exposures - MA(BS)1D" and to certify compliance with Part XV provisions in the "Certificate of Compliance - MA(BS)1F(a)".
- 6.3.2 Where necessary, the HKMA may require particular AIs to adhere to different reporting requirements in relation to large exposures.

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¹¹ The MA's power to revoke the authorization of an AI is exercisable when the AI fails to meet any minimum authorization criterion stipulated in the Seventh Schedule to the Banking Ordinance.