Annex

Clarifications on the treatment of extraordinary support measures related to Covid-19

1. What is the risk-based capital treatment of loans that are subject to government guarantees that have been made in response to the Covid-19 outbreak?

   Answer: When determining an AI's credit risk capital requirements for loans that are subject to sovereign guarantees, the relevant sovereign risk weight should be used, as set out in Parts 4, 5 and 6 of the Banking (Capital) Rules (BCR). The HKMA has provided guidance to the industry to this effect for relevant loan products subject to guarantee commitment of the Government.

2. What is the capital treatment of loans subject to payment holidays initiated in response to the Covid-19 outbreak?

   Answer: Following the principles set out in the BCBS technical clarifications[1], an AI may reflect the payment holiday granted for a loan (as a relief measure initiated by the AI in response to the Covid-19 outbreak) in determining the capital treatment of the credit exposure of the loan in the following manner:

   Under the standardized (credit risk) approach, for any loan that is not already a "past due exposure" as defined under Part 4 of the BCR when the payment holiday is granted, an AI, in determining whether a loan should be regarded as falling within the definition of "past due exposure":

   - may, in respect of calculating the **overdue period**, exclude the payment holiday period from the counting of days past due; and

   - should not automatically regard the granting of the payment holiday as necessarily leading to the loan being categorised as **rescheduled**.

   Likewise for the **internal ratings-based approach**:-

   - in assessing **whether an obligor is unlikely to pay in full** under section 149(1)(a) of the BCR, an AI should not automatically regard the granting of the payment holiday for a loan as necessarily constituting a "restructuring" of the loan, leading to the obligor being considered unlikely to pay in full its credit obligations. The AI's assessment of whether an obligor is unlikely to pay should be based on whether the

[1] https://www.bis.org/bcbs/publ/d498.pdf

obligor is unlikely to be able to repay in full its credit obligations after the payment holiday period ends; and

- in determining **whether an obligor is past due for more than 90 days** for the purposes of section 149(1)(b) and (2) of the BCR, an AI may exclude the payment holiday period from the counting of days past due for an exposure.

3. How should the HKMA's guidance on the reporting of rescheduled assets, overdue assets, and classified assets be applied in relation to loans subject to payment holidays initiated in response to the Covid-19 outbreak?

   Answer: An AI should refer to the FAQs issued by the HKMA to all AIs on 28 October 2019 and 10 March 2020 titled "Rescheduled loans" and "Treatments of relief measures for SMEs and retail clients", respectively. In sum:-

   - payment holidays initiated in response to the Covid-19 outbreak will not by themselves render a loan to be categorised as "rescheduled" so long as the terms of the payment holidays are "commercial";

   - if a loan is current or overdue for less than 1 month (less than 3 months for consumer loans repayable by regular monthly instalments) at the time the payment holiday is offered, it should not be reported as overdue until the loan is overdue under the rearranged payment schedule; and

   - the classification of a loan subject to payment holiday should reference the above guidelines on rescheduled and overdue assets as well as other loan characteristics stated in the HKMA's Guideline on Loan Classification System.

   The HKMA's reporting requirement stipulates that assets need to be reported as overdue once they have been overdue for more than 1 month.[2] The capital treatment established in the BCR and clarified in question 2 of this Annex on the other hand makes reference to "past due exposures"—assets that are more than 90 days past due—in line with the BCBS guidelines. The period of overdue relevant for regulatory reporting being shorter than that defines "past due exposures" in the capital treatment arises from the need for regulatory reporting to reflect in a timely manner emerging trends in asset quality. The abovementioned FAQs provide guidelines on the treatment of payment holidays having regard to this existing difference.

[2] See paragraph 12.2 of the Completion Instructions of MA(BS)2A.