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BANKING ORDINANCE (CHAPTER 155)  
CODE OF PRACTICE

The Monetary Authority, having consulted the persons specified in section 97M(2) of the Banking Ordinance (Chapter 155) and approved and issued a code of practice pursuant to section 97M(1) of that Ordinance, hereby, as required pursuant to section 97M(3) of that Ordinance-

- (a) identify the following code (with English and Chinese versions) as being that code entitled:
  - (i) in English — 'Code of Practice for the Purposes of Providing Guidance in Respect of the Provisions of Rules 20(4)(b), 31, 37(1)(a) and 41 of the Banking (Exposure Limits) Rules (Chapter 155[])'; and
  - (ii) in Chinese — 「就《銀行業(風險承擔限度)規則》(第 155[]章)第 20(4)(b), 31, 37(1)(a) 及 41 條的條文提供指引的實務守則」;
- (b) specify 1 July 2019 as the date on which the Monetary Authority's approval of the code is to take effect; and
- (c) specify the following provisions of the Banking (Exposure Limits) Rules (Chapter 155[]) as the relevant provisions for which the code is approved:
  - (i) Rule 20(4)(b);
  - (ii) Rule 31;
  - (iii) Rule 37(1)(a); and
  - (iv) Rule 41

Date

Norman T. L. Chan *Monetary Authority*

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# Code of Practice

**for the Purposes of Providing Guidance in Respect of  
the Provisions of Rules 20(4)(b), 31, 37(1)(a) and 41 of  
the Banking (Exposure Limits) Rules  
(Chapter 155[ ])**

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**Code of Practice for the Purposes of Providing Guidance in Respect of the  
Provisions of Rules 20(4)(b), 31, 37(1)(a) and 41 of the Banking (Exposure Limits)  
Rules (Chapter 155[])**

(Approved and issued by the Monetary Authority pursuant to  
section 97M(1) of the Banking Ordinance (Chapter 155))

**I. Preliminary**

**1. Interpretation**

- (1) In this code of practice—
  - (a) *BELR* means the Banking (Exposure Limits) Rules (Chapter 155[]).
- (2) All words and expressions used in this code of practice that are defined in the BELR have the same meaning as in the BELR.
- (3) Unless the context otherwise requires, a reference to a rule in this code of practice means a rule of the BELR.

**II. Guidance**

**2. Guidance on rule 20(4)(b) of the BELR in respect of “a competent and reliable third party market data provider”**

- (1) Rule 20(4) provides as follows—

“For subrule (1)(c), Formula B may be used if—

  - (a) the authorized institution has access to information with respect to the underlying exposure of the CIS and the following requirements are satisfied—
    - (i) the frequency of financial reporting of the CIS is not less frequent than that of the institution; and
    - (ii) the information is sufficient to allow the institution to value its equity exposure arising from the CIS by using that Formula; and
  - (b) the information provided to the institution under paragraph (a) is verified by an independent third party such as the depository, the custodian or the manager of the CIS, or the information is

subscribed information provided by a competent and reliable third party market data provider.”

- (2) In determining, for the purposes of rule 20(4)(b) of the BELR, whether a third party market data provider is competent and reliable, an AI should take into account the following in respect of the third party market data provider:
  - (a) market position and reputation;
  - (b) financial strength and service capability;
  - (c) track records;
  - (d) contingency service arrangements;
  - (e) any other factors that the AI may consider appropriate.

**3. Guidance on rule 31 of the BELR in respect of “a method to calculate an employee’s annual salary that the Monetary Authority considers reasonable”**

- (1) Rule 31 provides as follows:

“An authorized institution must, except with a consent given under rule 32, for each of its employees, at all times maintain an aggregate financial facility amount not exceeding the employee’s annual salary calculated by a method that the Monetary Authority considers reasonable.”
- (2) The Monetary Authority considers, for the purposes of rule 31 of the BELR, a method to calculate annual salary of an AI’s employee reasonable if the method reflects the sum of (i) the employee’s historical annual salary or annualised salary based on the employee’s latest fixed salary over a time interval (e.g. monthly); and (ii) any other fixed monetary payments and benefits payable to the employee such as fixed annual bonuses and housing allowances for the year concerned. Other variable payments and non-monetary benefits such as variable bonuses, performance based commissions and incentives, and medical insurance should be excluded from the calculation of the employee’s annual salary for the purposes of rule 31 of the BELR.

#### 4. **Guidance on rule 37(1)(a) of the BELR in respect of “interests in land”**

- (1) Rule 37(1) provides as follows:
  - “(1) Subject to rule 38—
    - (a) an authorized institution’s land exposure is the sum of the current book value of all interests in land held by the institution; and
    - (b) an authorized institution’s adjusted land exposure is the institution’s land exposure minus the sum of the current book value of all interests in the institution’s self-use land held by the institution.”
- (2) An AI should, for the purposes of rule 37(1)(a) of the BELR, regard its holding of units, shares or interests in a CIS or similar structure that has more than 80% of its investments in land as its interests in land.

#### 5. **Guidance on rule 41 of the BELR in respect of “economically dependent”**

- (1) Rule 41 provides as follows:
  - “(1) For this Part, subject to subrules (3), (4) and (5)—
    - (a) for a counterparty of an authorized institution (*reference counterparty*), another counterparty of the institution is a linked counterparty of the reference counterparty if the other counterparty is an entity specified in subrule (2); and
    - (b) the reference counterparty and all of its linked counterparties are collectively treated as an **LC group of the institution**.
- (2) The other counterparty is one that is—
  - (a) an entity that controls the reference counterparty;
  - (b) an entity that is controlled by the entity that controls the reference counterparty;
  - (c) an entity that is controlled by the reference counterparty;
  - (d) an entity that is not an entity specified in paragraph (a), (b) or (c), but is economically dependent on the reference

- counterparty or an entity specified in paragraph (a), (b) or (c);
- (e) an entity that is controlled by an entity specified in paragraph (d); or
  - (f) any other entity that—
    - (i) controls; and
    - (ii) is economically dependent on, an entity specified in paragraph (d).
- (3) For subrule (1), if the reference counterparty is a counterparty in relation to which the institution's ASCE ratio does not exceed 5% or is an exempted sovereign entity, the institution, in determining its ASC exposure to the LC group (by reference to the reference counterparty), may treat any of the following entities as not being in the LC group—
- (a) an entity specified in subrule (2)(d) that is economically dependent on the reference counterparty;
  - (b) an entity specified in subrule (2)(e) that is controlled by an entity specified in paragraph (a);
  - (c) an entity specified in subrule (2)(f) that controls and is economically dependent on the entity specified in paragraph (a).
- (4) For subrule (1), if a counterparty of an authorized institution (*counterparty A*) is a linked counterparty of the reference counterparty by virtue of subrule (2)(a), (b) or (c) and the institution's ASCE ratio in relation to the counterparty A does not exceed 5%, the institution, in determining its ASC exposure to the LC group (by reference to the reference counterparty), may treat any of the following entities as not being in the LC group—
- (a) an entity specified in subrule (2)(d) that is economically dependent on the counterparty A;
  - (b) an entity specified in subrule (2)(e) that is controlled by an entity specified in paragraph (a);
  - (c) an entity specified in subrule (2)(f) that controls and is economically dependent on the entity specified in paragraph (a).

- (5) For subrule (1), if 2 or more counterparties of an authorized institution—
- (a) are controlled by, or economically dependent on, an exempted sovereign entity or [The Financial Secretary Incorporated established under the Financial Secretary Incorporation Ordinance \(Cap. 1015\)](#); and
  - (b) are otherwise not in an LC group under subrule (1),  
[regardless of whether the exempted sovereign entity or The Financial Secretary Incorporated is a counterparty of the institution, the counterparties are treated as not being in an LC group of the institution.](#)
- (6) For [this rule](#), an entity (*subordinate entity*) is treated as being controlled by another entity (*parent entity*) if—
- (a) the parent entity owns more than 50% of the voting rights in the subordinate entity;
  - (b) the parent entity has control of a majority of the voting rights in the subordinate entity under an agreement with other shareholders (or similar holders of voting rights);
  - (c) the parent entity has the right to appoint or remove a majority of the members of the subordinate entity’s board of directors (or a similar governing body);
  - (d) a majority of the members of the subordinate entity’s board of directors (or a similar governing body) have been appointed solely as a result of the parent entity exercising its voting rights; or
  - (e) the parent entity has the power, under a contract or otherwise, to exercise a controlling influence over the management or policies of the subordinate entity.
- (7) For [this rule](#), an entity (*Entity A*) is economically dependent on another entity (*Entity B*) if they are connected in a way that if Entity B were to encounter financial problems (in particular funding or repayment difficulties), Entity A would also be likely to encounter financial problems (in particular funding or repayment difficulties).”
- (2) When an AI assesses, for the purposes of rules 41(2)(d), 41(2)(f)(ii), 41(3)(a) and 41(4)(a) of the BELR, whether a counterparty is



economically dependent on the reference counterparty, the AI may rely on information provided in good faith by either of the counterparties provided that such information is not in conflict with any information otherwise available to or in possession of the AI.

- (3) An AI should regard, for the purposes of rule 41(7) of the BELR, that if Entity B were to encounter financial problems (in particular funding or repayment difficulties), Entity A would also be likely to encounter financial problems (in particular funding or repayment difficulties) and hence Entity A is economically dependent on Entity B when any of the following applies:
  - (i) 50% or more of the gross receipts or gross expenditures (on an annual basis) of Entity A are derived from transactions with Entity B;
  - (ii) Entity A has fully or partly guaranteed the exposure of Entity B, or is liable in respect of that exposure in any other manner (e.g. by the giving of an indemnity), and the exposure is so significant that Entity A is likely to default if a claim occurs;
  - (iii) 50% or more of Entity A's product/output or services is sold to Entity B, and Entity B cannot easily be replaced by other customers;
  - (iv) the expected source of funds to repay the loans of both Entity A and Entity B is the same and neither Entity A nor Entity B has another independent source of income from which the loans may be fully repaid;
  - (v) it is likely that the financial problems of Entity B would cause difficulties for Entity A in terms of full and timely repayment of liabilities;
  - (vi) both Entity A and Entity B rely on the same source for 50% or more of their funding and neither Entity A nor Entity B has another independent source of funding.
- (4) To avoid doubt, when Entity A is economically dependent on Entity B, an AI should include Entity A in the LC group of Entity B. However, if Entity B is not economically dependent on Entity A, an AI should

not include Entity B in the LC group of Entity A unless Entity B meets other criteria for inclusion in the LC group of Entity A.