Q&As on Market Risk and CVA Risk

Unless otherwise specified, any reference in Q&As is a reference to the amended Part 8 or Part 8A of the Banking (Capital) Rules as introduced through the Banking (Capital) (Amendment) Rules 2023.

Market risk

Q1.	**An AI may manage the funding or liquidity needs of its foreign currencies in the banking book via funding swaps. However, these funding swaps are typically measured at fair value with value changes recognised in the profit and loss account. Should they be assigned to the trading book or the banking book?**
A1.	A funding swap would be classified as an accounting trading asset or liability unless it is designated as a hedging instrument under hedge accounting. Funding swaps therefore would be presumed to be trading book instruments in accordance with section 281B(3)(a). If an AI intends to deviate from the presumptive list of the trading book, it should submit a written request to the HKMA seeking an explicit approval in accordance with section 281B(4).
Q2.	**An AI may enter into internal transactions (e.g. funding swaps or term loans) between its trading book and banking book. Should these transactions be recognised for capital purposes?**
A2.	Internal transactions should not receive any capital recognition. However, an internal transaction that aims to transfer the general interest rate risk (GIRR) from the banking book to the trading book could receive capital recognition if the transaction fulfils the GIRR internal risk transfer (IRT) framework set out in section 281D(3).
Q3.	**For distressed loans or interest rate instruments recovered from distressed loans that are measured at fair value with value changes recognised in the profit and loss account, do they fall into the trading book presumptive list?**
A3.	Distressed loans or interest rate instruments recovered from distressed loans, where an AI enters into the transaction before the respective loan becomes distressed, do not fall into the trading book presumptive list and can remain in the banking book. They should, however, fall into the trading book presumptive list if the AI intentionally enters into the transaction after the respective loan becomes distressed for one or more of the purposes laid out under section 281B(1), e.g. profiting from short-term price movements.

Q4. A4.	**Section 281A(1) requires that an AI must assign direct holdings of real estate and derivatives on direct holding of real estate to its banking book. Could an AI assign Link Real Estate Investment Trust ("Link REIT", stock code: 823.HK), a constituent of Hang Seng Index, to its trading book?** Yes, an AI is allowed to treat a listed real estate investment trust that is a constituent of a qualified index as defined in section 281N(9) as a listed equity for the purpose of its regulatory book assignment.
Q5. A5.	**An AI may hedge its structural FX positions with a short FX derivative position, e.g. a short FX forward. Could that short FX position be also treated as part of the structural FX positions that are excluded from the calculation of its market risk capital charge for its foreign exchange risk as set out in section 281E(3)?** No, the short FX position should not be excluded from the calculation of its market risk capital charge. This is because the short FX position is not deliberately taken or maintained by the AI for the purpose of hedging partially or totally against any adverse effect of exchange rate movements on its capital adequacy ratio as set out in section 281E(3)(a). However, this should not prevent the AI from hedging the FX risk of its structural FX position. In this case, the AI can choose not to exclude all of its structural FX positions from the calculation of its market risk capital charge, allowing it to net off its long and short FX positions. For example, where an AI has total structural FX positions of 90 and a short FX position of 20, the AI can opt to exclude 70 of these structural FX positions from the calculation of its market risk capital charge, thereby allowing the remaining long FX position of 20 to be netted off against the short FX position of 20.
Q6. A6.	**How should CNY (onshore) and CNH (offshore) interest rate exposures be treated in the general interest rate risk of the sensitivities-based method?** In accordance with paragraph 3.3.4 of the SPM MR-1 "Market Risk Capital Charge", an onshore and an offshore currency curve (e.g. CNY and CNH) should be considered two different curves but belong to the same currency bucket.