Guideline 4.4.1

Our Ref. : CB/POL/3/11/5

29 June 1995

The Chief Executive
All locally incorporated authorised institutions

Dear Sir/Madam,

Amendments to the 1988 Capital Accord for Bilateral Netting

In February 1995, the HKMA issued a policy paper on the framework for broadening the recognition of bilateral netting of interest rate and exchange rate contracts ("rate contracts") for capital adequacy purposes. The paper sets out the conditions under which the HKMA is prepared to recognise netting arrangements and the method of calculating the credit exposure on bilaterally netted transactions for capital adequacy purposes.

The amendments to the Third Schedule to the Banking Ordinance which provide the legal framework for implementing the new system (Annex A) will be gazetted on 30 June 1995 and will take effect on the same date. Institutions intending to take advantage of bilateral netting arrangements may do so after that date. As indicated in our policy paper, such institutions are required to inform the HKMA in writing in advance the first time they intend to use a particular netting arrangement and to confirm that all the HKMA's requirements in respect of netting agreements (including the obtaining of legal opinions) have been met in respect of the netting agreement in question. Details of the HKMA's requirements are set out in paragraphs 10, 14 and 15 of the po1icy paper.

As regards the revised reporting requirements, the HKMA's February letter has already indicated that institutions which use the original exposure method with bilaterally netted rate contracts will be required to use the two replacement pages to the existing return at Annex B to report their rate contracts. While other institutions should continue to use the existing return to report their rate contracts, they should pay particular attention to the changes in the completion instructions at Annex C.

We have taken the opportunity of amending the Third Schedule to include an amendment to revise the definition of "Tier 1 country" to exclude any country which has re-scheduled its external sovereign debt in the previous 5 years. This is to bring the capital adequacy framework in line with recent amendments made to the 1988 Capital Accord by the BIS.

Should you have any queries on the implementation of bilateral netting framework, please feel free to contact Mr. Danny Leung (2878 8202) or Mr. C. K. Sum (2878 1624) of this office.

Yours faithfully,

D. T. R. Carse
Deputy Chief Executive (Banking)