Circulars

07 Dec 2004

Application for Use of the IRB Approach and the Basic Approach

Our Ref: S4/3C
CB/POL/4/5/2

7 December 2004

The Chief Executive
All locally incorporated AIs

Dear Sir / Madam,

Application for Use of the IRB Approach and the Basic Approach

Further to the recent consultation on proposals for implementing Basel II in Hong Kong, I am writing to inform you that the HKMA is now accepting formal applications from AIs that plan to use either the Basic Approach or the Foundation IRB Approach as from 1 January 2007, or the Advanced IRB Approach as from 1 January 2008.

IRB Approaches

In order to allow the HKMA to make plans for carrying out the necessary validations on their IRB systems, AIs wishing to use the Foundation IRB Approach in 2007 (or the Advanced IRB Approach in 2008) are requested to complete the attached IRB recognition request form (Annex 1) and return it to the HKMA by **31 December 2004**. AIs that plan to adopt the IRB Approach in later periods may also complete this form in order to facilitate the HKMA's planning for IRB recognition work.

Upon receipt of the IRB recognition request form, the HKMA will liaise with the AI concerned on the validation work that is required to check on whether their IRB systems/models and the risk management practices surrounding the use of such systems/models can meet the specified minimum standards. While the details are yet to be finalised, the examination procedures for the use of the IRB approach by AIs will follow closely the IRB recognition process outlined in Section 5.2 of the Addendum. In particular, the examination procedures will include a set of self-assessment questionnaires and an on-site examination to review both the technical details of the systems/models and the risk management practices that govern the use of those systems/models.

In the case of AIs that are subsidiaries of foreign banking groups, the HKMA will liaise with the relevant home supervisor, particularly on the recognition arrangements to assess the extent of reliance that may be placed on the validation work done by the home supervisor.

Basic Approach

As mentioned in the implementation proposals, the HKMA will have regard to the size and complexity of an AI's operations in considering whether to grant approval to use the Basic Approach, the simplest version under the revised capital framework in Hong Kong under Basel II. In terms of credit risk capital measurement, the Approach builds on the OECD framework of Basel I with some slight definitional changes. Annex 2 is a preliminary summary of these changes, on which the HKMA will consult the industry shortly.

AIs that will be considered for approval will generally be limited to those with a total asset size of not more than HK$10bn and with relatively simple and straight-forward operations. Approval may also be considered under exceptional circumstances, such as impending revocation of authorisation, which may render the adoption of the Standardised Approach not justified. Where applicable, AIs are expected to provide relevant information to support their application.

AIs that have a definite plan to adopt the Foundation IRB Approach during the transition period from 1 January 2007 to 31 December 2009 (or the Advanced IRB Approach as from 1 January 2008) may be allowed to use the Basic Approach on a transitional basis, subject to the HKMA being satisfied with their IRB implementation and rollout plans. Any exposures exempt from the IRB Approach which remain on the Basic Approach at the end of 2009 should migrate to the Standardised Approach at that time. AIs that wish to apply to use the Basic Approach for all or part of their exposures during the transition period are requested to provide the HKMA with details of their IRB rollout plans, including the type and amount of exposures that will use the Basic Approach (or the Standardised Approach where applicable) and the time period for which such approach(es) will be used. The HKMA may ask individual AIs to provide additional information to support or justify their application.

In line with the application timeline set out in the implementation proposals, please submit, where applicable, the application letter and other forms as mentioned earlier, to the HKMA (by post or by fax at 2878 1899 and addressed to Mr Eric Lo) **by end-December 2004**. Please also feel free to contact us if you have any queries:

for IRB Approach - Mr Ip-wing Yu (2878 1446) or Mr Chi-kau Lee (2878 8271).

for Basic Approach - Mr Richard Chu (2878 8276) or Mr Banny Yu (2878 8267).

Yours faithfully,

Simon Topping
Executive Director (Banking Policy)

Encl. Annex 1 (MS Word, 22KB)
Table 1 (MS Excel, 23KB)
Annex 2 (MS Word, 26KB)

Last revision date : 01 August 2011