HONG KONG MONETARY AUTHORITY
香港金融管理局

Circulars

23 Jun 2006

Basel II - External Credit Assessment Institutions' Ratings and Mapping of Ratings to Risk-Weights

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23 June 2006

The Chief Executive
All authorized institutions

Dear Sir/Madam,

Basel II - External Credit Assessment Institutions' Ratings and Mapping of Ratings to Risk-Weights

I am pleased to inform you that, following consultation with the industry and the external credit assessment institutions ("ECAIs") which are currently recognized by the Monetary Authority ("MA") for banking supervisory purposes, the HKMA has now finalized its policy paper on Recognition of ECAIs for Basel II purposes. The policy paper is attached at Annex 1.

In addition, based on the eligibility criteria and the mapping approach set out in the policy paper, the HKMA has completed its assessments on Fitch Ratings, Moody's Investors Service, Standard & Poor's Ratings Services, and Rating and Investment Information, Inc. ("R&I") and now proposes that their assessments for non-securitization exposures be recognized for the Standardized Approach to calculation of credit risk under the revised capital framework. A list of these ECAIs and the mapping of their risk assessments to the credit quality grades / risk-weights for exposures to sovereigns, banks and securities firms, and corporates is now attached at Annex 2, which will be included in the Capital Rules to be made by the MA. Unsolicited ratings issued by these ECAIs will receive the same treatment as solicited ratings under the Capital Rules.

We are still in the process of reviewing the assessment methodologies of the recognized ECAIs for securitization transactions and considering the mapping of the relevant credit assessments of the ECAIs. We will publish a separate list of the recognized ECAIs and the mapping of their credit assessments for the Securitization Framework to be prescribed in the Capital Rules at a later stage.

Authorized institutions ("AIs") that intend to adopt the Standardized Approach may start to nominate ECAIs and inform the HKMA of their nominations. What this means in practice is that each AI needs to tell us which of the four ECAIs we have recognized they plan to use plus any others that they would propose to use which we have not yet assessed for recognition so that we can initiate the recognition process. Where an AI proposes to use the assessments of an ECAI that is not currently recognized by the HKMA, the HKMA will approach the ECAI inviting an application for recognition. Whether the assessment of the ECAI's eligibility can be completed before the implementation of the Capital Rules will depend on whether the HKMA has been provided sufficient lead time to undertake the recognition process and to obtain the necessary information from the ECAI.

While the policy paper on Recognition of ECAIs has been mainly developed for implementation of Basel II, it will also be relevant for the recognition of ECAIs for other purposes by the HKMA, i.e. the minimum acceptable ratings of recognized ECAIs for the lender of last resort arrangement, the market risk capital adequacy framework, the liquidity ratio requirement under the Banking Ordinance and the profits tax concession scheme under section 14A(4)(b) of the Inland Revenue Ordinance. All the ECAIs listed in Annex 2 have already been recognized for these other purposes by the HKMA. However, based on our updated assessment of the quality of R&I's ratings, the minimum acceptable rating of R&I has been changed from BBB+ to BBB-. The revised list of recognized ECAIs and the respective minimum acceptable ratings, with immediate effect, is attached at **Annex 3**. A gazette notice and a press release, as attached at **Annexes 4 and 5**, have also been released today to announce the list of recognized ECAIs and the respective minimum acceptable ratings for the purposes of the profits tax concession scheme under section 14A(4)(b) of the Inland Revenue Ordinance.

The policy paper and the list of recognized ECAIs and the mapping of their ratings for various purposes mentioned above may be subject to future changes if considered appropriate.

Yours faithfully,

Simon Topping
Executive Director (Banking Policy)

Encl. ECAIs (Annex 1) (Word file, 135KB)
ECAIs (Annex 2) (PDF file, 19KB)
ECAIs (Annex 3) (Word file, 37KB)
ECAIs (Annex 4) (PDF file, 175KB)
ECAIs (Annex 5) (Word file, 29KB)

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