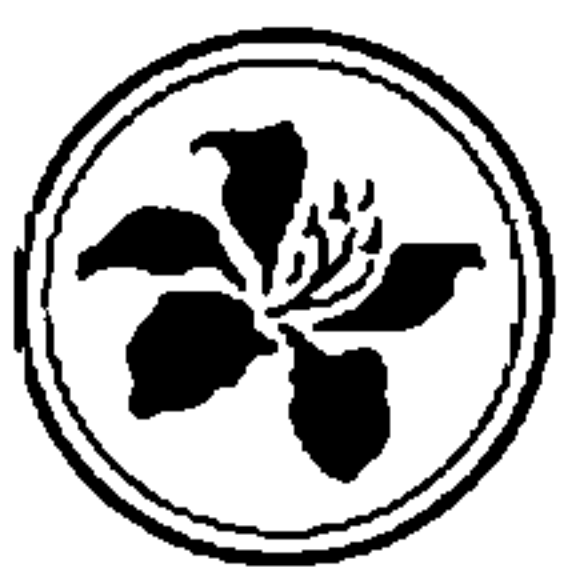




HONG KONG MONETARY AUTHORITY
香港金融管理局

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8 October 2014

By email and by hand

Mr Lee Huat Oon
Acting Chairman
The DTC Association
Unit 1704, 17/F, Bonham Trade Centre
50 Bonham Strand East
Sheung Wan
Hong Kong

Dear Mr Lee,

Consultation on draft Supervisory Policy Manual (SPM) module “Systemically Important Banks”

I am writing to seek the Association’s comments on a new SPM module, “Systemically Important Banks”, which the Monetary Authority (MA) proposes to issue as a statutory guideline.

Following the recent global financial crisis, the Basel Committee on Banking Supervision (Basel Committee) has established policy frameworks to address the risks posed by global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs). The rationale for adopting additional policy measures for systemically important banks is the significant “negative externalities” (i.e. adverse side effects) which these banks could create if they were to become non-viable. The work of the Basel Committee forms part of a broader effort by the Financial Stability Board to make these banks less susceptible to failure and thereby improve the resilience of the financial system and economy as a whole.

The additional policy measures include the application of a Higher Loss Absorbency (HLA) capital requirement to G-SIBs and D-SIBs, together with more intensive supervision and prioritised recovery and resolution planning requirements.

The new SPM module is intended to complement the Banking (Capital) Rules (as amended from 1 January 2015 by the Banking (Capital) (Amendment) Rules (BCAR) 2014¹ upon which the industry has recently been consulted) and covers:

- (i) **Overview of the D-SIB framework** – in sections 1 and 2, the module provides an overview of the D-SIB framework in Hong Kong and the MA’s power to

¹ The BCAR 2014 will empower the MA to designate G-SIBs and D-SIBs and the applicable HLA requirements. Sections of the Banking (Capital) Rules mentioned in the draft SPM module are based on the sections of the draft BCAR 2014 sent to your Association on 11 August 2014.

designate authorized institutions (AIs) as D-SIBs and to apply HLA requirements to these D-SIBs.

- (ii) **MA approach to D-SIBs** – in section 3, the module explains the approach underlying the D-SIB assessment leading to designation:
- The first step is to draw up a preliminary indicative list of D-SIBs using an indicator-based approach by reference to the following four factors: size, interconnectedness, substitutability and complexity. The “size”, “interconnectedness” and “substitutability” factors will be measured by quantitative indicators. A weight will be assigned to each of the quantitative indicators and factors. Based on these weights, an overall systemic score (which is the sum of an AI’s weighted scores for all the indicators) will then be calculated for each of the AIs within the D-SIB assessment pool. The “complexity” factor will be assessed using a qualitative approach, as no suitable and readily available quantitative indicator has as yet been identified to accommodate the multifaceted nature of complexity.
 - The second step is to apply supervisory judgement to the indicator-based measurement as described above. This step is intended to take account of factors that cannot be appropriately captured by a purely quantitative indicator-based measurement approach.
- (iii) **Consequences of D-SIB designation** – in sections 4 to 6, the module explains the consequences of being designated as a D-SIB:
- An HLA requirement, which is expressed as Common Equity Tier 1 capital as a percentage of total risk-weighted assets, will be applied to a D-SIB based on its degree of systemic importance. Given the diversified nature and varying degree of systemic importance of AIs in Hong Kong, the MA intends to adopt a “bucketing approach” to achieve a degree of differentiation between D-SIBs. Each D-SIB will be allocated to a bucket corresponding to a required level of HLA ranging from 1% to 2.5% of total risk-weighted assets, with an empty top bucket of 3.5% to provide an incentive for the most systemically important D-SIBs to refrain from becoming even more systemically important in the future.
 - The MA will fine-tune the intensity of supervision of D-SIBs in Hong Kong. AIs designated as D-SIBs are expected to adhere to higher standards in general, in terms of risk culture and risk management; corporate governance; and internal controls. In order to strengthen their data processing capabilities and risk reporting practices so as to support better risk identification and measurement, D-SIBs will also be expected to be in a position to comply with the *Principles for effective risk data aggregation and risk reporting*² issued by the Basel Committee in January 2013 within three years of their designation.
 - There will be continued focus on the recovery and resolution plans of D-SIBs so as to reduce the probability or impact of failure of D-SIBs.

² <http://www.bis.org/publ/bcbs239.pdf>

- (iv) **Announcement of D-SIBs** – in section 7, the module provides an outline of the process for public announcements regarding the designation of D-SIBs.
- (v) **Disclosure requirements applicable to D-SIBs** – in section 8, the module describes the disclosure requirements applicable to AIs designated as D-SIBs. Currently there are no specific additional disclosure requirements for AIs designated as D-SIBs in addition to those under the Banking (Disclosure) Rules (BDR). However, once the Basel Committee's new international standard on Pillar 3 disclosure requirements is finalised, the MA will consider making appropriate amendments to the BDR, including any additional disclosure requirements for D-SIBs.
- (vi) **MA approach to G-SIB designation** – in section 9, the module describes the MA's approach to applying the G-SIB framework in Hong Kong. This includes the MA's power to designate AIs as G-SIBs, and to apply an HLA requirement to such G-SIBs. The MA's assessment methodology basically adopts the Basel Committee's G-SIB framework. AIs satisfying any of the prescribed criteria will be required to report data on the relevant G-SIB indicators and make disclosures in line with the Basel Committee's G-SIB requirements. In addition, as with D-SIBs, any local G-SIBs will be expected to adhere to higher standards in terms of recovery and resolution planning, risk culture as well as data processing and risk reporting capabilities.

I would be grateful if the Association's comments on the draft SPM module could reach us by 19 November 2014. On-line access to the draft SPM module is available under the icon for "Supervisory Policy Manual" on the HKMA's public website (<http://www.hkma.gov.hk/eng/key-functions/banking-stability/supervisory-policy-manual.shtml>). Should you have any questions regarding the enclosed draft module, please feel free to contact me (msprenger@hkma.gov.hk) or Ms Carita Wan (carita_pm_wan@hkma.gov.hk).

I am writing in similar terms to the Hong Kong Association of Banks, and members of the Banking Advisory Committee and the Deposit-taking Companies Advisory Committee.

Yours sincerely,

Martin Sprenger
Acting Executive Director (Banking Policy)

Encl

cc: FSTB (Attn: Mr Jackie Liu)