Our Ref.: B1/15C
B9/75C
B9/151C

31 December 2014

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Implementation guidance on Banking (Capital) Rules and Banking (Disclosure) Rules

Following the implementation of Basel II in 2007, the HKMA has issued guidance in the form of questions and answers ("Q&As") on a number of areas in the Banking (Capital) Rules ("BCR"). Such Q&As were included:

(a) with a circular letter of 25 May 2007 on "Implementation guidance on Banking (Capital) Rules" covering[1]:

  (i) the calculation of credit risk for non-securitization exposures under the IRB approach;
  (ii) the calculation of credit risk for securitization exposures;
  (iii) the calculation of market risk; and

(b) with a circular letter of 4 September 2013 on "Basel III implementation – Frequently Asked Questions ("FAQs")", covering the counterparty credit risk framework[2].

The recent assessment by the Basel Committee of Hong Kong's compliance with the Basel 2/2.5/3 standards under the Committee's Regulatory Consistency Assessment Programme has observed that additional supervisory guidance, including in the form of Q&As, might be beneficial in securing consistent implementation of certain requirements under the BCR and the Banking (Disclosure) Rules ("BDR"). Furthermore, some existing Q&As require some updating to reflect the passage of time and the implementation of revised or new Basel capital standards. I therefore enclose revised Q&As relating to the BCR as well as the BDR covering:

- revisions or updates to the Q&As on capital calculation approaches mentioned under item (a) above (please refer to **Annex 1**). The major changes relate to –

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[1] See http://www.hkma.gov.hk/eng/key-information/guidelines-and-circulars/circulars/2007/20070525-1.shtml
[2] See http://www.hkma.gov.hk/eng/key-functions/banking-stability/basel-3.shtml

- the IRB capital floor requirements, reflecting the amendments set out in the HKMA's circular letter of 20 December 2013;

- the treatment of default within a connected group, to elaborate on the application of relevant provisions under the IRB approach;

- the IRB top-down approach to calculate the risk-weighted amount for default risk of purchased receivables, to provide further guidance on the use of this approach; and

- the factors for considering whether a foreign exchange position of an authorized institution would qualify as a "structural position" for the purposes of market risk calculation.

• a new Q&A to be included into those mentioned in item (b) above to provide guidance on the calculation of the delta-adjusted notional amount of an eligible instrument for hedging CVA risk (i.e. in the form of an option on a credit default swap) as requested by the industry during the consultation on the Banking (Capital) (Amendment) Rules 2013 (please refer to **Annex 2**).

• some new Q&As in respect of (i) the calculation of credit risk for non-securitization exposures under the Standardised Approach and (ii) the general disclosures for credit risk to facilitate the consistent understanding of certain provisions of the BCR and the BDR (please refer to **Annex 2**).

The Q&As have been drafted, as far as possible, in simple non-legal language to facilitate consistent interpretation and application of the capital or disclosure requirements. They are however explanatory and supplementary in nature and do not seek to replace (and should not be read as replacing) any requirements in the BCR or the BDR. Also, the Q&As are inevitably general in scope and do not take into account the particular circumstances of individual authorized institutions. As such, the reading of the Q&As is no substitute for the reading of the BCR and the BDR themselves or for obtaining, where necessary, legal and other professional advice on particular aspects of the BCR and the BDR.

We intend to amalgamate the enclosed Q&As with those on the HKMA public website in order to provide access through a single document link.

Yours faithfully,

Karen Kemp
Executive Director (Banking Policy)

Encl.

c.c. The Chairman, The Hong Kong Association of Banks
The Chairman, The DTC Association
FSTB (Attn: Mr Jackie Liu)