

Proposed amendments to Banking (Capital) Rules (“BCR”) for implementing Basel III revised operational risk capital framework

Item 1. Repeal the following existing definitions in section 2(1) of the BCR

Existing definitions to be repealed		Remarks (including references)
(1)	<i>alternative standardized approach</i>	This definition is no longer required because the concerned approach will be repealed under the revised operational risk capital framework (“revised framework”).
(2)	<i>ASA approach</i>	This definition is no longer required because the concerned approach will be repealed under the revised framework.
(3)	<i>basic indicator approach</i>	This definition is no longer required because the concerned approach will be repealed under the revised framework”.
(4)	<i>BIA approach</i>	This definition is no longer required because the concerned approach will be repealed under the revised framework.
(5)	<i>gross income</i>	This term is the proxy for operational risk under the existing operational risk capital framework. It will be replaced by other proxies under the revised framework.
(6)	<i>last 3 years</i>	Please see remarks for the new definition “last n years” in item 7(15) below.
(7)	<i>standardized business line</i>	This term becomes obsolete under the revised framework.

Existing definitions to be repealed		Remarks (including references)
(8)	<i>standardized (operational risk) approach</i>	This definition is no longer required because the concerned approach will be repealed under the revised framework.
(9)	<i>STO approach</i>	This definition is no longer required because the concerned approach will be repealed under the revised framework.

Item 2. Amend the following existing definition in section 2(1) of the BCR

Existing definition – amendment to be made		Remarks (including references)
(1)	<i>internal model</i> – remove the reference to “operational risk”.	This is an amendment to clarify that internal model is not relevant to the methodology for the calculation of operational risk capital charge under the revised framework.

Item 3. Repeal the following existing provisions in Part 2 of the BCR

Existing provisions to be repealed		Remarks (including references)
(1)	Division 6	This Division is no longer required with the repeal of the existing three approaches under the revised framework.
(2)	Subsections (3) and (4) of section 32	These subsections are no longer required with the repeal of the existing three approaches under the revised framework.

Item 4. Amend the following existing provisions in Part 2 of the BCR

Existing provisions – amendments to be made		Remarks (including references)
(1)	Title and subsections (1) and (2) of section 33A – remove reference to “25(2)(a)”.	Section 25 is part of the existing Division 6 of the BCR to be repealed as mentioned in item 3(1).
(2)	Subsection (1) of section 34 – remove reference to “25(2)”.	Section 25 is part of the existing Division 6 of the BCR to be repealed as mentioned in item 3(1).

Item 5. Repeal the following existing Schedules of the BCR

Existing schedules to be repealed		Remarks (including references)
(1)	Schedule 4	This Schedule is no longer required with the repeal of the existing STO approach and ASA approach under the revised framework.
(2)	Schedule 15	The revised framework no longer contains the existing two approaches (i.e. STO approach and ASA approach) to which this Schedule is relevant.

Item 6. Substitute the contents of Part 9 of the BCR with the provisions to be incorporated in accordance with items 7 to 13 below

Matters to be provided		Remarks (including references)
(1)	Repeal the entire Part 9 of the BCR.	The contents of Part 9 of the BCR are to be repealed and replaced with new provisions set out in items 7 to 13 below.

Item 7. Add the following definitions to a Division in Part 9 of the BCR for the interpretation of Part 9

Definitions		Remarks (including references)
(1)	Basel Framework means the consolidated version of the Basel Committee’s global standards for the regulation and supervision of banks published by the Basel Committee in December 2019 and as amended or supplemented from time to time.	References to chapters OPE10 and OPE25 of the Basel Framework in this document refer to the version of these chapters to be effective as of 1 January 2023. They are accessible through clicking the “View future version” link for each of these chapters on the “OPE – Calculation of RWA for operational risk” webpage of the Basel Framework (https://www.bis.org/basel_framework/standard/OPE.htm).
(2)	BI means the Business Indicator, which is determined in accordance with items 9 and 10.	This definition is intended to signpost the term to the relevant items in this document for its determination for ease of reference. <u>Basel Framework reference:</u> OPE25.1
(3)	BIC means the Business Indicator Component, which is determined in accordance with item 11.	This definition is intended to signpost the term to the relevant item in this document for its determination for ease of reference.
(4)	dividend income , in relation to an authorized institution (“AI”)’s calculation of the ILDC, means dividend income from equity investments in entities and collective investment schemes as specified by the Monetary Authority (“MA”) based on chapter OPE10 of the Basel Framework.	<u>Basel Framework reference:</u> OPE10.2 (Table 1) The term “collective investment scheme” is defined under section 2(1) of the BCR.

Definitions		Remarks (including references)
		<u>Supervisory guidance:</u> Further explanation of this definition will be provided in supervisory guidance such as in the form of a code of practice, or supervisory policy manual, etc. (“SG”), having regard to the description of the term set out in OPE10.2 (Table 1) of the Basel Framework.
(5)	FC means the Financial Component of the BI, which is determined in accordance with items 9 and 10.	This definition is intended to signpost the term to the relevant items in this document for its determination for ease of reference.
(6)	fee and commission expenses , in relation to an AI’s calculation of the SC, means expenses paid for receiving advice and services as specified by the MA based on chapter OPE10 of the Basel Framework.	<u>Basel Framework reference:</u> OPE10.2 (Table 1) <u>Supervisory guidance:</u> Further explanation of this definition will be provided in SG having regard to the description of the term set out in OPE10.2 (Table 1) of the Basel Framework.
(7)	fee and commission income , in relation to an AI’s calculation of the SC, means income received from advice and services as specified by the MA based on chapter OPE10 of the Basel Framework.	<u>Basel Framework reference:</u> OPE10.2 (Table 1) <u>Supervisory guidance:</u> Further explanation of this definition will be provided in SG having regard to the description of the term set out in OPE10.2 (Table 1) of the Basel Framework.

Definitions		Remarks (including references)
(8)	first year , in relation to the last n years, means the last calendar quarter of the period and the 3 immediately preceding calendar quarters.	The terms “first year”, “second year”, “third year”, and “year” are defined based on the existing definitions of these terms under section 323 of the BCR.
(9)	high quality operational loss data means data on operational loss that meet the standards prescribed by the MA in relation to the identification, collection, treatment validation, review, scope and content, etc. of loss data based on the “minimum standards for the use of loss data under the standardized approach” set out in chapter OPE25 of the Basel Framework.	<u>Supervisory guidance:</u> The standards for high quality operational loss data will be provided in SG based on relevant criteria set out in chapter OPE25 of the Basel Framework (i.e. OPE25.14 to 25.34).
(10)	ILDC means the Interest, Leases and Dividend Component of the BI, which is determined in accordance with items 9 and 10.	This definition is intended to signpost the term to the relevant items in this document for its determination for ease of reference.
(11)	ILM , in relation to an AI’s calculation of its capital charge for operational risk, means the Internal Loss Multiplier as determined in accordance with items 12 and 13.	This definition is intended to signpost the term to the relevant items in this document for its determination for ease of reference.
(12)	interest earning assets , in relation to an AI’s calculation of the ILDC, means interest bearing assets and leased assets as specified by the MA based on chapter OPE10 of the Basel Framework.	<u>Basel Framework reference:</u> OPE10.2 (Table 1) <u>Supervisory guidance:</u> Further explanation of this definition will be provided in SG having regard to the description of the term set out in OPE10.2 (Table 1) of the Basel Framework.

Definitions		Remarks (including references)
(13)	interest expenses , in relation to an AI's calculation of the ILDC, means ordinary interest expenses and the expenses and losses related to leased assets as specified by the MA based on chapter OPE10 of the Basel Framework.	<u>Basel Framework reference:</u> OPE10.2 (Table 1) <u>Supervisory guidance:</u> Further explanation of this definition will be provided in SG having regard to the description of the term set out in OPE10.2 (Table 1) of the Basel Framework.
(14)	interest income , in relation to an AI's calculation of the ILDC, means ordinary interest income and the income and profits related to leased assets as specified by the MA based on chapter OPE10 of the Basel Framework.	<u>Basel Framework reference:</u> OPE10.2 (Table 1) <u>Supervisory guidance:</u> Further explanation of this definition will be provided in SG having regard to the description of the term set out in OPE10.2 (Table 1) of the Basel Framework.
(15)	last n years means the last n years ending on a calendar quarter end date, where n can be any of the following: 3, 5, 10 or any integral number between 5 and 10.	References to “last 3 years” in the existing definitions are replaced by “the last n years” to cater not only for the calculation of BI (which is based on data of the last 3 years) but also the calculation of ILM (which can be based on data of the last 5 years, 10 years or any number of years between the last 5 and the last 10 years).
(16)	LC means the Loss Component, which is determined in accordance with items 12 and 13.	This definition is intended to signpost the term to the relevant items in this document for its determination for ease of reference.

Definitions		Remarks (including references)
(17)	net interest income , in relation to an AI, means interest income after deducting its interest expenses.	This term is based on the definition of the same term under existing section 323 of the BCR.
(18)	Net P&L on banking book , in relation to an AI's calculation of the FC, means the "gains minus losses" arising from assets and liabilities booked in the banking book as specified by the MA based on chapter OPE10 of the Basel Framework.	<u>Basel Framework reference:</u> OPE10.2 (Table 1) (The term "banking book" is defined under section 2(1) of the BCR.) <u>Supervisory guidance:</u> Further explanation of this definition will be provided in SG having regard to the description of the term set out in OPE10.2 (Table 1) of the Basel Framework.
(19)	Net P&L on trading book , in relation to an AI's calculation of the FC, means the "gains minus losses" arising from assets and liabilities booked in the trading book as specified by the MA based on chapter OPE10 of the Basel Framework.	<u>Basel Framework reference:</u> OPE10.2 (Table 1) (The term "trading book" is defined under section 2(1) of the BCR.) <u>Supervisory guidance:</u> Further explanation of this definition will be provided in SG having regard to the description of the term set out in OPE10.2 (Table 1) of the Basel Framework.

Definitions		Remarks (including references)
(20)	operational loss event means any event as specified by the MA based on Table 2 in chapter OPE25 of the Basel Framework, the classification of an operational loss into which forms part of the requirements that the operational loss data of an AI must meet in order for the data to be considered as high quality operational loss data.	<u>Supervisory guidance:</u> Guidance based on Table 2 in chapter OPE25 of the Basel Framework will be set out in SG.
(21)	other operating expenses , in relation to an AI's calculation of the SC, means expenses and losses from ordinary operations not included in other components of the BI as specified by the MA based on chapter OPE10 of the Basel Framework.	<u>Basel Framework reference:</u> OPE10.2 (Table 1) <u>Supervisory guidance:</u> Further explanation of this definition will be provided in SG having regard to the description of the term set out in OPE10.2 (Table 1) of the Basel Framework.
(22)	other operating income , in relation to an AI's calculation of the SC, means income from ordinary operations not included in other components of the BI, as specified by the MA based on chapter OPE10 of the Basel Framework.	<u>Basel Framework reference:</u> OPE10.2 (Table 1) <u>Supervisory guidance:</u> Further explanation of this definition will be provided in SG having regard to the description of the term set out in OPE10.2 (Table 1) of the Basel Framework.
(23)	second year , in relation to the last n years , means the year immediately preceding the first year .	The terms “first year”, “second year”, “third year”, and “year” are defined based on the existing definitions of these terms under section 323 of the BCR.
(24)	SC means the Services Component of the BI, which is determined in	This definition is intended to signpost the term to the

Definitions		Remarks (including references)
	accordance with items 9 and 10.	relevant items in this document for its determination for ease of reference.
(25)	third year , in relation to the last n years , means the year immediately preceding the second year .	The terms “first year”, “second year”, “third year”, and “year” are defined based on the existing definitions of these terms under section 323 of the BCR.
(26)	year means a period of 4 consecutive calendar quarters.	This term is defined based on the existing definition of this term under section 323 of the BCR. The HKMA proposes to follow the approach of the current BCR to regard a “year” as a (moving) period of 4 consecutive calendar quarters rather than the financial year of the institution. This approach applies to the calculation of all the Business Indicator components and the Loss Component.

Item 8. Add a Division in Part 9 of the BCR to set out an overall framework that an AI is required to follow for the calculation of the risk-weighted amount of its exposure to operational risk

Matters to be provided		Remarks (including references)
(1)	To provide that an AI must calculate the risk-weighted amount of its exposure to operational risk by multiplying the capital charge for operational risk by 12.5.	<u>Basel Framework reference:</u> OPE25.2

Matters to be provided		Remarks (including references)
(2)	To provide that, subject to item 8(3), an AI must calculate its capital charge for operational risk by multiplying its Business Indicator Component (BIC) by its Internal Loss Multiplier (ILM).	<u>Basel Framework reference:</u> OPE25.2
(3)	To provide that where an AI has been in operation for less than 18 months on any calendar quarter end date subsequent to the date on which this section comes into operation, the institution must obtain the prior consent of the MA on the use of either the method prescribed in this Part, or an alternative method, for calculating its capital charge for operational risk.	This item is a modification of section 340 of the BCR to cater for the revised framework. Similar to the current practice under such section, we will not specify a particular alternative method. (The term “calendar quarter end date” is defined under section 2(1) of the BCR.)

Item 9. Add a Division in Part 9 of the BCR to set out the methodology that an AI is required to follow for the calculation of its BIC

Matters to be provided		Remarks (including references)
(1)	To provide that an AI must, after each calendar quarter end date - (a) calculate its Business Indicator (BI) as the sum of the following 3 components, each as determined respectively under items 9(2), (3) and (4): (i) Interest, Leases and Dividend Component (ILDC); (ii) Services Component (SC); and (iii) Financial Component (FC), and (b) for the determination of ILDC, SC and FC, include the data of any acquired business and merged activities over the period prior to the	<u>Basel Framework reference:</u> OPE25.3, 25.4, 25.7 and 25.34

Matters to be provided		Remarks (including references)
	acquisition/merger that is relevant to the calculation; and (c) convert its BI to its BIC in accordance with item 11.	
(2)	To provide that an AI must determine the ILDC as the sum of- (a) the lower of- (i) the arithmetic mean of the absolute value of the net interest income for the last 3 years; and (ii) 2.25% times the arithmetic mean of the interest earning assets for the last 3 years; and (b) the arithmetic mean of the dividend income for the last 3 years.	<u>Basel Framework reference:</u> OPE25.5 <u>Supervisory guidance:</u> As mentioned under item 7(14), (13), (12) and (4), we intend to replicate OPE10.2 (Table 1) of the Basel Framework in SG to provide guidance for the following items: • “interest income” (component for calculating “net interest income”; • “interest expenses” (component for calculating “net interest income”; • “interest earning assets”; and • “dividend income”.
(3)	To provide that an AI must determine the SC as the sum of- (a) the higher of- (i) the arithmetic mean of the other operating income for the last 3 years and	<u>Basel Framework reference:</u> OPE25.5 <u>Supervisory guidance:</u> As mentioned under item 7(22), (21), (7) and (6), we intend to replicate OPE10.2 (Table 1) of the Basel Framework in

Matters to be provided		Remarks (including references)
	(ii) the arithmetic mean of the other operating expenses for the last 3 years, and (b) the higher of- (i) the arithmetic mean of the fee and commission income for the last 3 years; and (ii) the arithmetic mean of the fee and commission expenses for the last 3 years.	SG to provide guidance for the following items: • “other operating income”; • “other operating expenses”; • “fee and commission income”; and • “fee and commission expenses”.
(4)	To provide that an AI must determine the FC as the sum of- (a) the arithmetic mean of the absolute value of the net P&L on trading book for the last 3 years; and (b) the arithmetic mean of the absolute value of the net P&L on banking book for the last 3 years.	<u>Basel Framework reference:</u> OPE25.5 <u>Supervisory guidance:</u> As mentioned under item 7(19) and (18), we intend to replicate OPE10.2 (Table 1) of the Basel Framework in SG to provide guidance for the following items: • “net P&L on trading book”; and • “net P&L on banking book”.
(5)	To provide that an AI must determine the arithmetic mean of the income referred to in item 9(2)(b) and each of the income or expenses referred to in item 9(3) for the last 3 years by: (a) aggregating the income or expenses for the last 3 years; and (b) dividing the aggregate figure arrived at in (a) by 3.	<u>Basel Framework reference:</u> OPE25.5

Matters to be provided		Remarks (including references)
(6)	To provide that an AI must determine the arithmetic mean of the interest earning assets referred to in item 9(2)(a)(ii) for the last 3 years by: (a) determining the arithmetic mean of the institution's interest earning assets as at the 4 calendar quarter end dates of the first year; (b) determining the arithmetic mean of the institution's interest earning assets as at the 4 calendar quarter end dates of the second year; (c) determining the arithmetic mean of the institution's interest earning assets as at the 4 calendar quarter end dates of the third year; and (d) dividing the sum of the figures arrived at in (a), (b) and (c) by 3.	<u>Basel Framework reference:</u> OPE25.5
(7)	To provide that an AI must determine the arithmetic mean of the absolute value of the net interest income referred to in item 9(2)(a)(i) and each of the net P&L referred to in item 9(4) for the last 3 years by: (a) determining the absolute value of the net interest income or the net P&L recognized by the institution in the first year; (b) determining the absolute value of the net interest income or the net P&L recognized by the institution in the second year; (c) determining the absolute value of the net interest income or the net P&L recognized by the institution in the third year; and (d) dividing the sum of the figures arrived at in (a), (b) and (c) by 3.	<u>Basel Framework reference:</u> OPE25.5 footnote 1
(8)	To provide that where, on any calendar quarter end date subsequent to the date on which this section comes into operation, an AI has been in operation for 18 months or more but less than 3 years, the institution shall treat any	Items 9(8) and (9) are modifications of the transitional arrangements specified under section 341 of the BCR to

Matters to be provided		Remarks (including references)
	partial year of operation of 6 months or more as a full year, and any partial year of operation of less than 6 months as zero, for the purpose of calculating any arithmetic mean referred to in items 9(5), (6) and (7) for the last 3 years.	cater for the more granular parameters in the revised framework.
(9)	To provide that, without prejudice to item 9(8), on any calendar quarter end date subsequent to the date on which this section comes into operation – (a) Where an AI has been in operation for 2 years and 6 months or more but less than 3 years, the AI must – (i) determine the arithmetic mean of the income referred to in item 9(2)(b) and each of the income or expenses referred to in item 9(3) for the last 3 years by: (A) aggregating the income or expenses for the first year and the second year; (B) annualising the income or expenses for the partial year; and (C) dividing the sum of the figures arrived at in (A) and (B) by 3. (ii) determine the arithmetic mean of the interest earning assets referred to in item 9(2)(a)(ii) for the last 3 years by: (A) determining the arithmetic mean of the institution's interest earning assets as at the 4 calendar quarter end dates of the first year;	Items 9(8) and (9) are modifications of the transitional arrangements specified under section 341 of the BCR to cater for the more granular parameters in the revised framework.

Matters to be provided	Remarks (including references)
(B) determining the arithmetic mean of the institution's interest earning assets as at the 4 calendar quarter end dates of the second year; (C) determining the arithmetic mean of the institution's interest earning assets outstanding at the end of each full calendar quarter within the partial year; and (D) dividing the sum of the figures arrived at in (A), (B) and (C) by 3. (iii) determine the arithmetic mean of the absolute value of the net interest income referred to in item 9(2)(a)(i) and each of the net P&L referred to in item 9(4) for the last 3 years by: (A) determining the absolute value of the net interest income or the net P&L recognized by the institution in the first year; (B) determining the absolute value of the net interest income or the net P&L recognized by the institution in the second year; (C) annualising the absolute value of the net interest income or the net P&L recognized by the institution of the partial year; and (D) dividing the sum of the figures arrived at in (A), (B) and (C) by 3. (b) Where an AI has been in operation for 2 years or more but less than 2 years and 6 months, the AI must –	

Matters to be provided	Remarks (including references)
(i) determine the arithmetic mean of the income referred to in item 9(2)(b) and each of the income or expenses referred to in item 9(3) for the last 3 years by: (A) aggregating the income or expenses for the first year and the second year; and (B) dividing the aggregate figure arrived at in (A) by 2. (ii) determine the arithmetic mean of the interest earning assets referred to in item 9(2)(a)(ii) for the last 3 years by: (A) determining the arithmetic mean of the institution's interest earning assets as at the 4 calendar quarter end dates of the first year; (B) determining the arithmetic mean of the institution's interest earning assets as at the 4 calendar quarter end dates of the second year; and (C) dividing the sum of the figures arrived at in (A) and (B) by 2. (iii) determine the arithmetic mean of the absolute value of the net interest income referred to in item 9(2)(a)(i) and each of the net P&L referred to in sub-item 9(4) for the last 3 years by: (A) determining the absolute value of the net interest income or the net P&L recognized by the institution in the first year;	

Matters to be provided	Remarks (including references)
(B) determining the absolute value of the net interest income or the net P&L recognized by the institution in the second year; and (C) dividing the sum of the figures arrived at in (A) and (B) by 2. (c) Where an AI has been in operation for 18 months or more but less than 2 years, the AI must – (i) determine the arithmetic mean of the income referred to in item 9(2)(b) and each of the income or expenses referred to in item 9(3) for the last 3 years by: (A) determining the income or expenses for the first year; (B) annualising the income or expenses for the partial year; and (C) dividing the sum of the figures arrived at in (A) and (B) by 2. (ii) determine the arithmetic mean of the interest earning assets referred to in item 9(2)(a)(ii) for the last 3 years by: (A) determining the arithmetic mean of the institution's interest earning assets as at the 4 calendar quarter end dates of the first year; (B) determining the arithmetic mean of the institution's interest earning assets outstanding at the end of each full calendar quarter within the partial year; and	

Matters to be provided		Remarks (including references)
	(C) dividing the sum of the figures arrived at in (A) and (B) by 2. (iii) determine the arithmetic mean of the absolute value of the net interest income referred to in item 9(2)(a)(i) and each of the net P&L referred to in item 9(4) for the last 3 years by: (A) determining the absolute value of the net interest income or the net P&L recognized by the institution in the first year; (B) annualising the absolute value of the net interest income or the net P&L recognized by the institution of the partial year; and (C) dividing the sum of the figures arrived at in (A) and (B) by 2.	

Item 10. Add a Division in Part 9 of the BCR to set out the required exclusions from the BI

Matters to be provided		Remarks (including references)
(1)	To provide that an AI must not take into account any of the following items in the calculation of the BI: (a) income and expenses from insurance or reinsurance businesses; (b) premiums paid and reimbursements/payments received from insurance or reinsurance policies purchased; (c) administrative expenses, including staff expenses, outsourcing fees	<u>Basel Framework reference:</u> OPE10.3 Note: For item 10(1)(f), reference to “interest expenses” (instead of to “financial and operating lease expenses” under OPE 10.3(6)) is intentional. “Financial and operating lease expenses” is not intended to be a defined term in the

Matters to be provided		Remarks (including references)
	paid for the supply of non-financial services (e.g. logistical, IT, human resources), and other administrative expenses (e.g. utilities, telephone, travel, office supplies, postage); (d) recovery of administrative expenses including recovery of payments on behalf of customers (e.g. taxes debited to customers); (e) expenses of premises and fixed assets (except when these expenses result from operational loss events); (f) depreciation/amortisation of tangible and intangible assets (except depreciation arising from operating lease assets should be included in interest expenses); (g) provisions/reversal of provisions (e.g. on pensions, commitments and guarantees given) except for provisions arising from operational loss events; (h) expenses due to share capital repayable on demand; (i) impairment/reversal of impairment (e.g. on financial assets, non-financial assets, investments in subsidiaries, joint ventures and associates); (j) changes in goodwill recognized in P&L accounts; and (k) corporate income tax (tax based on profits including current tax and deferred tax).	BCR, and is subsumed under the defined term “interest expenses”.
(2)	To provide that the MA may approve an AI to exclude data related to its divested businesses and activities from the calculation of the BI, if the	<u>Basel Framework reference:</u> OPE25.33

Matters to be provided		Remarks (including references)
	institution demonstrates to the satisfaction of the MA that the divested businesses and activities are no longer relevant to its risk profile.	[Note: such exclusions must be disclosed in accordance with the Pillar 3 requirements.]

Item 11. Add a Division in Part 9 of the BCR to set out the methodology that an AI is required to follow for converting the BI into the BIC

Matters to be provided		Remarks (including references)								
(1)	To provide that an AI must determine its BIC by - (a) separating its BI into 3 portions as shown in the following Table; (b) multiplying each portion with the corresponding marginal coefficient as shown in the Table; and (c) aggregating the 3 products arrived at for the 3 portions. <table><tr><td>Portion of BI (HK\$' billion)</td><td>Marginal coefficient</td></tr><tr><td>10 or less</td><td>12%</td></tr><tr><td>Over 10 and up to 300</td><td>15%</td></tr><tr><td>Over 300</td><td>18%</td></tr></table>	Portion of BI (HK\$' billion)	Marginal coefficient	10 or less	12%	Over 10 and up to 300	15%	Over 300	18%	<u>Basel Framework reference:</u> OPE25.7 (an example is given in Footnote 2 that follows OPE25.7). € is converted into HK\$ at an exchange rate of €1 = HK\$10.
Portion of BI (HK\$' billion)	Marginal coefficient									
10 or less	12%									
Over 10 and up to 300	15%									
Over 300	18%									

Item 12. Add a Division in Part 9 of the BCR to set out the methodology that an AI is required to follow for the determination of its ILM

Matters to be provided		Remarks (including references)								
(1)	To provide that for the purpose of determining the ILM, an AI must be classified into one of the following 3 categories based on the size of its BI: <table><tr><td>BI (HK\$' billion)</td><td>Category</td></tr><tr><td>10 or less</td><td>Bucket 1 AI</td></tr><tr><td>Over 10 and up to 300</td><td>Bucket 2 AI</td></tr><tr><td>Over 300</td><td>Bucket 3 AI</td></tr></table>	BI (HK\$' billion)	Category	10 or less	Bucket 1 AI	Over 10 and up to 300	Bucket 2 AI	Over 300	Bucket 3 AI	<u>Basel Framework reference:</u> The categorisation is in line with the classification of banks as described in OPE25.11 and 25.18.
BI (HK\$' billion)	Category									
10 or less	Bucket 1 AI									
Over 10 and up to 300	Bucket 2 AI									
Over 300	Bucket 3 AI									
(2)	To provide that subject to item 12(11), any Bucket 1 AI must take its ILM as 1.	<u>Basel Framework reference:</u> OPE25.11								
(3)	To provide that subject to item 12(7), any Bucket 2 or Bucket 3 AI that meets the requirement set out in item 12(4) must determine its ILM based on the below formula (Formula A): <u>Formula A</u> $\text{ILM} = \ln [\exp(1) - 1 + (\text{LC}/\text{BIC})^{0.8}]$ where LC is the AI's Loss Component which is calculated by multiplying the arithmetic mean of its operational risk losses incurred over the following period by 15:	<u>Basel Framework reference:</u> OPE25.8 and 25.12 OPE25.15 (which requires “all years of good-quality data available beyond 5 years must be included”). We do not intend to require the annualising of operational loss in a partial year since operational loss does not occur regularly or on an ongoing basis, hence annualisation is not a good way to proxy annual operative loss.								

Matters to be provided		Remarks (including references)
	(i) if the institution has maintained high quality operational loss data for the last 10 years or more, the period is the last 10 years; and (ii) if the institution has maintained high quality operational loss data for the last 5 years or more but less than the last 10 years, the period is such number of years.	<u>Supervisory guidance:</u> See remarks for “high quality operational loss data” under item 7(9). Guidance will be provided in SG to explain this term.
(4)	To provide that if an AI is to calculate its ILM by Formula A set out under item 12(3) according to the provisions in this Division, it must have maintained high quality operational loss data for at least the last 5 years.	<u>Basel Framework reference:</u> <u>OPE25.10</u> (without exercising the MA’s discretion to allow an AI to calculate its ILM using less than 5 years of high quality operational loss data). <u>Supervisory guidance:</u> See remarks for “high quality operational loss data” and “operational loss event” under items 7(9) and (20) respectively. Guidance will be provided in SG to explain these terms.
(5)	To provide that in calculating the “operational risk losses” in a year for the purpose of determining its ILM based on Formula A, an AI must take the sum of the gross loss amounts of any operational loss events recognized by the institution in the year minus the recovery amounts of any operational loss events received by the institution in the same year.	<u>Basel Framework reference:</u> OPE25.25 (which provides that banks should use losses net of recoveries in the loss dataset) and OPE25.29 (which provides that losses should be allocated to the corresponding years of the loss dataset in line with their accounting treatment). <u>Supervisory guidance:</u> Guidance on the computation of the gross loss amount will be provided in SG based on OPE25.24 to 25.27 of the Basel

Matters to be provided		Remarks (including references)
		Framework.
(6)	To provide that: (a) An AI must calculate “the arithmetic mean of the operational risk losses” for a period of the last 10 years, or any number of years between 5 and 10 years, as the case requires, by (i) calculating the amounts of operational risk losses for the first year and every year preceding the first year in the period; (ii) aggregating the amounts of operational risk losses for all the years in the period; and (iii) dividing the result in (ii) by the number of years in the period; and (b) Where, on any calendar quarter end date subsequent to the date on which this section comes into operation, the number of years is between 5 and 10 years, an AI must treat any partial year of more than 6 months as a full year and any partial year of less than 6 months as zero.	<u>BCR reference:</u> The OPE chapters of the Basel Framework do not specify the treatment of a partial year. Our intended treatment follows the spirit of section 341(2)(a)(ii) of the BCR, which takes into account the data in a partial year of 6 months or more in the calculation. However, we do not intend to require the annualising of operational loss in a partial year since operational loss does not occur regularly or on an ongoing basis, hence annualisation is not a good way to proxy annual operational loss.
(7)	To provide that subject to items 12(8), (9) and (10), any Bucket 2 or Bucket 3 AI which does not meet the requirement set out in item 12(4) must take its ILM as 1.25.	<u>Basel Framework reference:</u> OPE25.10 (see remarks for item 12(4)). Requiring such AIs to take ILM as 1.25 is a local treatment to reflect the MA’s intention to penalise AIs which fail to meet the relevant data or event classification requirements.

Matters to be provided		Remarks (including references)
(8)	To provide that any AI, on first becoming a Bucket 2 or Bucket 3 AI, may initially take its ILM as 1 for a transitional period of no longer than 9 months or any other period as agreed by the MA, and must determine its ILM based on Formula A after such period.	This is a local treatment to provide some leniency taking into account industry comments received during the consultation.
(9)	To provide that, unless otherwise approved by the MA, any newly established Bucket 2 or Bucket 3 AI that has been in operation for less than 5 years must take its ILM as 1.	This is a local treatment to provide some leniency to those newly established AIs falling within this scenario, which is expected to be a rare occurrence in practice. The “unless otherwise approved by the MA” wording is intended to be a flexibility, where necessary, to tailor the ILM value (e.g. in case a value higher than 1 is considered appropriate to hasten an AI’s compliance with the data requirements) to cater for circumstances peculiar to each case.
(10)	To provide that: (a) for any Bucket 2 or Bucket 3 AI that is required to calculate its capital adequacy ratio on both a solo basis and a consolidated basis under section 3C of the BCR, if it only meets the requirement set out in item 12(4) on a solo basis but not on a consolidated basis, it must take the following as its ILM on a consolidated basis: (i) 1.25 if its ILM determined on a solo basis based on Formula A is less than or equal to 1; or (ii) the higher of 1.25 or its ILM determined on a solo basis based on Formula A, if the latter is higher than 1; and	This is a local treatment that is consistent with OPE25.13 of the Basel Framework. When an AI can meet the data quality standards only on a solo basis but not a consolidated basis, we propose that its ILM on a consolidated basis should be the higher of 1.25 or the value of the solo ILM. Making the ILM larger than 1 should provide an incentive for AIs to meet the data quality standards on a consolidated basis. 1.25 is determined by expert judgement, to which the industry did not object during consultation of the policy proposal.

Matters to be provided		Remarks (including references)
	(b) in this item 12(10), a reference to calculating the capital adequacy ratio on a solo basis means calculating the ratio on a solo-consolidated basis for any AI that has been granted the MA's approval to do so under section 28(2)(a) of the BCR.	
(11)	To provide that any Bucket 1 AI may calculate its ILM based on Formula A if: (a) it meets the following conditions: (i) it is a subsidiary of a larger banking group; and (ii) it has notified the MA that the following conditions are met at least 3 months prior to wishing to calculate its ILM by Formula A: • it meets the requirement set out in item 12(4); • its parent company calculates ILM on a consolidated basis under the capital rules applicable to such company; and • its operational loss data are either included in the calculation of its parent company's ILM or would be included in such calculation were it not for justifiable considerations such as the materiality of the institution in relation to its banking group, or (b) it has obtained the MA's prior consent to do so.	<u>Basel Framework reference:</u> OPE25.11 (item 12(11)(a) is a local requirement to address industry comments received during the consultation). OPE25.11 provides a discretion for supervisors to allow Bucket 1 banks to calculate their own ILMs. Item 12(11)(b) caters for the situation where the MA decides to exercise this discretion more generally at a later stage when relevant loss data reported by Bucket 1 AIs evidence that they can meet the standards for high quality operational loss data as specified by the MA in accordance/alignment with OPE25 (please also see proposed definition for "high quality operational loss data" in item 7(9) above).

Item 13. Add a Division in Part 9 of the BCR to set out the required exclusions from the LC

Matters to be provided	Remarks (including references)
(1) To provide that for the purpose of calculating its LC, an AI must exclude the losses arising from an operational loss event under any of the following situations: (a) the cumulative losses after deduction of recoveries arising from the event over the period referred to in item 12(3) is less than a threshold prescribed by the MA in accordance with OPE25.18 of the Basel Framework; (b) the losses have been accounted for in the risk-weighted amount for credit risk; or (c) the MA has approved the institution to exclude the losses arising from the event from the calculation.	<u>Basel Framework reference:</u> OPE25.18, 25.20, 25.30 and 25.32 • <u>Supervisory guidance:</u> The threshold under item 13(1)(a) will be set out in SG at €20,000 (i.e. HK\$200,000) based on OPE25.18. We do not presently intend to exercise the discretion in OPE25.18 to increase the threshold to €100,000 (i.e. HK\$1,000,000), but including a threshold in SG will provide us with the flexibility to adjust it quickly in the future if necessary.
(2) To provide that the MA will grant the approval in item 13(1)(c) if he considers it prudent to exclude such losses having regard to the risk profile of the institution.	• Guidance on the conditions that an AI needs to satisfy for the MA to grant the approval will be set out in SG. The conditions are based on Basel Framework OPE25.30 and 25.32, viz., where (i) the loss event is no longer relevant to the AI's risk profile, (ii) the loss amount is significant enough to justify for the exclusion and (iii) the loss has been included in the AI's operational losses (for LC calculation) for at least 3 years. The MA may also consider approving exclusion under other scenarios on a case by case basis.