

### III. STC Approach

#### 1. Due diligence requirements

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| <b>Q1.</b> | <b><sup>1</sup>Could more guidance be provided on the due diligence requirements set out in §54C(1)?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| A1.        | <p>An AI must, instead of relying on external credit ratings, conduct its own credit assessments (at origination and at least annually thereafter) to ensure that it has an adequate understanding of the risk profile and characteristics of the obligors in respect of its exposures. §54C(1) applies to both rated and unrated exposures.</p> <p>The sophistication of the due diligence should be commensurate with the size and complexity of the AI's activities. The AI must take reasonable and adequate steps to assess the operating and financial performance levels and trends of each obligor through internal credit analysis and/or other analytics outsourced to a third party, as appropriate for the obligor. The AI must be able to access information about the obligor on a regular basis to complete due diligence analyses.</p> <p>For exposures to an obligor belonging to a group of companies, due diligence should, to the extent possible, be performed at the solo entity level to which the AI has an exposure. In evaluating the repayment capacity of the obligor, the AI is expected to take into account the support of the group and the potential for the obligor to be adversely impacted by problems in the group.</p> <p>Also, the AI should be prepared to demonstrate that its due diligence analyses are appropriate if requested by the HKMA. As part of the supervisory review, the HKMA will consider whether the AI has appropriately performed its due diligence analyses, and, where appropriate, take necessary supervisory measures when there are deficiencies in any of the analyses.</p> <p>The above requirements are similar to those set out in the SPM modules on credit risk management, which should already be the standard credit risk management practices of AIs. Hence, AIs are not expected to require to make substantial change to their credit risk management process in order to comply with §54C(1).</p> |
| <b>Q2.</b> | <b>Could immaterial exposures, such as utility deposits, rental deposits, etc. where an AI does not maintain a corporate relationship with the counterparty concerned (e.g. utility provider or the landlord), be exempted from the due diligence requirements?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| A2.        | For exposures that are advance payments made, or collateral provided, by an AI to a service provider/supplier or landlord that pertain to the AI's operating expenses, such as utility deposits and rental deposits paid by the AI for its offices, there is no need to perform due diligence as required under §54C(1) of the BCR.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| <b>Q3.</b> | <b>Is due diligence required on exposures such as interbank balances, time deposits and nostros?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |

<sup>1</sup> Reference: Basel Framework CRE20.4, 20.5 and 20.6.

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| A3.        | Due diligence is required on interbank balances, time deposits and nostros as they are credit exposures to banks.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| <b>Q4.</b> | <b>Regarding the due diligence requirements related to ECAI ratings set out in §54C(2), what is the supervisory expectation of the HKMA? Specifically, would AIs be expected to perform a line by line comparison of the underlying risk characteristics considered in the AIs' internal credit assessments with those in the external rating assessments?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| A4.        | <p>The objective of the due diligence requirements is to ensure that the risk-weight assigned to an exposure is reflective of the level of credit risk assessed by an AI itself. AIs are not required to assess whether the external credit rating of an exposure is appropriate or not. The HKMA's expectation is as follows—</p> <ul style="list-style-type: none"> <li>(a) <sup>2</sup>AIs should have in place effective internal policies, processes, systems and controls to ensure that appropriate risk-weights are assigned to obligors;</li> <li>(b) for capital purposes, an AI is required to develop a mapping scheme that maps the AI's own credit assessment result (e.g. an internal credit quality grade) to an equivalent external credit rating (based on the credit standing such rating represents). The mapping does not need to be a line by line comparison of the underlying risk characteristics considered in the AI's internal credit assessment and the external rating assessment. There is also no requirement that the mapping must be based on outcomes of credit models; and</li> <li>(c) the AI should compare the outcome of its own internal credit assessment and the risk-weight determined based on the external credit rating assigned to the exposure concerned (or, if there is no such rating, an applicable external credit rating determined under §54E). If an AI uses the outcomes of credit models for the purpose of the comparison, the AI is reminded that the use of credit models must never result in the application of a lower risk-weight than that determined based on the external credit rating (see §54C(3)).</li> </ul> <p>The HKMA will take a proportionate approach to considering the appropriateness of an AI's mapping scheme and expect AIs to be prepared to justify the reasonableness of their mapping mechanism.</p> |
| <b>Q5.</b> | <b>Could an AI leverage the internal credit rating assessment results and mapping scheme for external ratings prepared by the AI's parent bank for the due diligence process discussed in A4?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| A5.        | An AI may adopt the mapping scheme between internal credit ratings and external credit ratings developed by the AI's parent bank if the AI's internal credit rating system is the same as that of its parent bank. In general, the AI is expected to conduct the internal credit assessment by itself. The AI may leverage the internal credit ratings assessment results prepared by its parent bank only under very limited circumstances, for example, both the parent bank's exposure and the AI's exposure are to the same bond.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |

<sup>2</sup> Reference: Basel Framework CRE20.6.

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| <b>Q6.</b> | <b><sup>3</sup>Should AIs assess climate-related financial risks as part of the due diligence analyses with respect to obligors and credit exposures?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| A6.        | <p>Climate-related financial risks can impact AIs' credit exposures through obligors/counterparties. To the extent that the risk profile/creditworthiness of an obligor or counterparty is affected by climate-related financial risks, AIs are expected to give proper consideration, on a best effort basis given the challenges arising from, for example, methodological and data limitations that cannot be fully resolved currently, to the climate-related financial risks as part of the due diligence (in other words, AIs are expected to integrate climate-related financial risks in their own credit risk assessment and, if applicable, when performing due diligence in respect of risk-weights based on external ratings as required by §54C(2)).</p> <p>The HKMA will adopt a pragmatic approach and apply the proportionality principle in line with the implementation approach of SPM GS-1 "Climate Risk Management".</p> |

## **2. Unspecified multilateral body exposures**

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| <b>Q7.</b> | <b>Would the HKMA provide any guidance with respect to the definition of "unspecified multilateral body" in §2(1), particularly on the concepts of "large sovereign membership", "mandate similar to the mandates of multilateral development banks" and "considerable number of the owners of which are also the owners of multilateral development banks"?</b>           |
| A7.        | The HKMA does not intend to set any thresholds for "large", "considerable" or "similar" as different cases may result in different judgements based on the own merits of each case. An AI may consult the HKMA if there is a specific case in which the AI is unable to form a view on whether an obligor to which it has an exposure is an unspecified multilateral body. |

## **3. Eligible covered bonds**

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| <b>Q8.</b> | <b><sup>4</sup>What are the conditions that must be met in order for a covered bond to be classified as an eligible covered bond?</b>                                                                                                                                                                                                  |
| A8.        | <p>In order to be eligible for the risk-weighting treatments set out in §59D(1), (2) and (3), the following conditions must be met in respect of the covered bonds concerned—</p> <p>(a) the assets securing the payment obligations attached to the covered bonds ("cover pool") include any one or more of the following assets:</p> |

<sup>3</sup> Reference: FAQs inserted to Basel Framework CRE20.4, 20.20 and 20.42.

<sup>4</sup> Reference: Basel Framework CRE20.34 to CRE20.37.

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|  | <p>(i) claims on, or claims guaranteed by, any one or more of the following entities (as defined in the BCR):</p> <ul style="list-style-type: none"> <li>• sovereigns;</li> <li>• public sector entities;</li> <li>• multilateral development banks;</li> <li>• unspecified multilateral bodies;</li> </ul> <p>(ii) claims secured by residential real estate that meet the criteria set out in Basel Framework CRE20.71 (or §65(1) or (3) in the case of loans originated in Hong Kong) and with a loan-to-value ratio of 80% or lower;</p> <p>(iii) claims secured by commercial real estate that meet the criteria set out in Basel Framework CRE20.71 (or §65(1) in the case of loans originated in Hong Kong) and with a loan-to-value ratio of 60% or lower;</p> <p>(iv) claims on, or claims guaranteed by, banks that would qualify for a 30% or lower risk-weight under the STC approach. However, such claims cannot exceed 15% of the aggregate principal amount of the outstanding covered bonds.</p> <p>(b) the nominal value of the assets in the cover pool (“cover assets”) should exceed the aggregate principal amount of the outstanding covered bonds by at least 10% (“10% requirement”). The value of the cover assets for this purpose does not need to be that required by the legislative framework that governs the covered bonds. However, if the legislative framework does not stipulate a 10% requirement, the issuer needs to publicly disclose on a regular basis that the cover pool meets the 10% requirement in practice. In addition to the primary assets<sup>5</sup>, additional collateral may include substitution assets<sup>6</sup> (cash or short-term liquid and secure assets held in substitution of the primary assets to top up the cover pool for management purposes) and derivative contracts entered into for the purposes of hedging the risks arising in the covered bond program concerned; and</p> <p>(c) the investing AI is able to demonstrate to the satisfaction of the MA that—</p> <p>(i) it receives portfolio information at least on:</p> <ul style="list-style-type: none"> <li>• the value of the cover pool and outstanding covered bonds;</li> <li>• the geographical distribution and type of the cover assets, and their loan size;</li> </ul> |
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<sup>5</sup> “Primary assets” means dominant assets included in a cover pool that determine the nature of the pool.

<sup>6</sup> “Substitution assets” means assets in the cover pool that contribute to the coverage requirements (i.e. the extent of overcollateralization), other than the primary assets.

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|             | <ul style="list-style-type: none"> <li>• details in relation to interest rate risk and currency risk;</li> <li>• the maturity structure of the cover assets and the covered bonds; and</li> <li>• the percentage of loans more than 90 days past due; and</li> </ul> <p>(ii) the issuer of the covered bonds makes the information referred to in paragraph (c)(i) available to the AI at least semi-annually.</p> <p>The conditions set out in paragraphs (a) and (b) must be satisfied at the inception of the covered bonds and throughout its remaining maturity.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| <b>Q9.</b>  | <b>According to A8(a)(ii) and (iii) above, the claims within the cover pool must be regulatory real estate exposures with a loan-to-value ratio not exceeding a certain level. Since the information provided by the covered bond issuer is usually on portfolio level only, investing AIs may not be able to verify whether individual claims meet the requirements in A8(a)(ii) and (iii). Guidance is needed from the HKMA in this respect.</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| A9.         | <p>The loan-to-value ratio (“LTV ratio”) mentioned in A8(a)(ii) and (iii) is the ratio of a single loan (or in cases where more than one loan is secured by the same property, all those loans in aggregate), rather than the weighted average LTV ratio of the cover pool or the LTV ratio of the cover pool calculated by dividing the total of all outstanding balances of the loans in the cover pool by the total values of the properties securing those loans.</p> <p>AIs may rely on the warranties and representations made by the originator of the loans, and the eligibility criteria that must be met by assets for inclusion in the cover pool, as set out in the relevant covered bond programme documentation. If the eligibility criteria under a covered bond programme do not include a criterion on the maximum LTV ratio of a loan, but there is a maximum LTV ratio under the asset coverage test or for the purpose of calculating the extent of overcollateralisation, AIs may refer to the latter maximum LTV ratio for the purposes of the conditions mentioned in A8(a)(ii) and (iii).</p> |
| <b>Q10.</b> | <b>Clarification is sought on whether “loan-to-value ratio” mentioned in A8(a)(ii) and (iii) refers to the original LTV ratio of a loan at bond inception and/or the current LTV ratio at the time of capital computation/reporting.</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| A10.        | <p>Since A8(a)(ii) and (iii) are on-going requirements, “LTV ratio” refers to the status at bond inception as well as the current status.</p> <p>For the purpose of determining whether the condition in A8(a)(ii) or (iii) is met, “LTV ratio” is the one calculated in the way specified in the relevant law or regulations governing issuance of covered bonds or in the covered bond programme documentation*, and the current LTV ratio is the one disclosed in the most recent disclosure (e.g. investor report) made by the covered bond issuer.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |

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|  | <p>* For example, the LTV ratio could be calculated as the ratio of the loan amount included in the cover pool to the current market valuation (CMV) of the property. The loan amount included in the cover pool is not necessarily equal to the current outstanding amount of the loan. The legal requirement or the covered bond programme documentation may provide that if the ratio of current outstanding loan amount to CMV of the property is more than 80%, the loan amount that can be included in the cover pool is 80% of the CMV of the property.</p> |
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#### 4. **Bank exposures**

##### Risk-weights inferred from short-term ECAI issue specific ratings

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| <b>Q11.</b> | <b>Does §59A(2) refer to exposures with an original maturity between 6 and 12 months?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| A11.        | <p>The exposure referred to in the chapeau of §59A(2) is—</p> <p>(a) an exposure with an original maturity of not more than 6 months that is <u>not</u> associated with cross-border movement of goods, including any 3 months' exposure as defined in §51(1); or</p> <p>(b) an exposure with an original maturity between 6 and 12 months, whether associated with cross-border movement of goods or not.</p> <p>Reference exposures referred to in §59A(2)(a)(ii) and (b) are exposures that have a short-term ECAI issue specific rating. There is no need to consider the maturity of a reference exposure for the purpose of §59A(2).</p> |

##### Standardized credit risk assessment approach ("SCRA")

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| <b>Q12.</b> | <b><sup>7</sup> To what extent should climate-related financial risks be taken into consideration when determining whether a bank is eligible for a credit assessment grade of A?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| A12.        | <p>Given the challenges arising from, for example, methodological and data limitations that cannot be fully resolved currently, an AI is expected to, on a best effort basis, consider the impact of material climate-related financial risks on the bank's capacity to meet its financial commitments in a timely manner for the projected life of the AI's exposures to that bank. Prudent practice by the AI to evaluate the bank's ability to repay commitments could include incorporating consideration of material climate-related financial risks into the entire credit life cycle, including client due diligence as part of the on-boarding process and ongoing monitoring of clients' risk profiles.</p> <p>The HKMA will adopt a pragmatic approach and apply the proportionality principle in line with the implementation approach of SPM GS-1 "Climate Risk Management".</p> |
| <b>Q13.</b> | <b>When assessing whether a credit assessment grade of A can be assigned to a bank for an AI's capital reporting at a quarter end, if it is not feasible to base</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |

<sup>7</sup> Reference: FAQ inserted to Basel Framework CRE20.22.

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|             | <b>the SCRA assessment on the same quarter-end capital position of the bank (which is not publicly available at the time of the AI's capital reporting), can the AI base the assessment on last year's or last quarter's CET1 capital ratio and leverage ratio of the bank?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| A13.        | AIs may use the latest publicly available information to conduct the assessment.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <b>Q14.</b> | <b>How often should the SCRA assessment of a bank be conducted?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| A14.        | <p>Generally speaking, the SCRA assessment consists of two components—</p> <ul style="list-style-type: none"> <li>(a) assessment of a bank's capacity to meet its financial commitments in a timely manner for the projected life of the assets or exposures concerned; and</li> <li>(b) the extent the published minimum regulatory requirements are met.</li> </ul> <p>Component (a) can be based on the annual credit review conducted by an AI using the latest available published information unless there is any adverse change (e.g. any material adverse changes in the business, financial or economic conditions) that warrants immediate reassessment.</p> <p>Component (b) should be updated when new published information is available. Hence, if a bank publishes new regulatory ratios quarterly, component (b) should be updated quarterly.</p> |
| <b>Q15.</b> | <b>If a bank declares in its publicly disclosed financial statements/regulatory reports that it has complied with all minimum regulatory requirements, but the detailed ratios are not disclosed in the statements/reports, is it acceptable to treat the bank as having met the quantitative requirements for grade B?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| A15.        | For a commercial bank other than an AI, it must fall within paragraph (b)(ii)(A) or (B) of the definition of "bank" in §2(1) of the BCR, otherwise, the bank must not be classified as "bank" for the purposes of the BCR. If the regulatory framework to which the bank is subject does not include disclosure requirements on the bank's regulatory ratios (e.g. requirements similar to Template KM1 (Key metrics (at consolidated group level)) set out in DIS20 of the Basel Framework), this would call into question whether such bank falls within the definition of "bank" in §2(1) of the BCR.                                                                                                                                                                                                                                                          |
| <b>Q16.</b> | <b>Under the SCRA, if the sovereign in which a bank is incorporated has an attributed risk-weight of 100% and the bank is assigned a credit assessment grade of B (i.e. the applicable risk-weight is 75% or 50% under §59C(1), should the risk-weight of 100% be allocated to exposures to the bank to which §59C(3) applies?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| A16.        | The applicable risk-weights for unrated exposures to banks are those set out in Table 4A under §59C(1) and §59C(2) of the BCR. The wording of §59C(3) is that "... an unrated exposure to a bank must not be <u>allocated under subsection (1) or (2)</u> a risk-weight that is lower than the attributed risk-weight of the sovereign of the bank's home jurisdiction if ..." (emphasis added). Accordingly, if the attributed risk-weight of the sovereign concerned is 100%, the risk-weight available in                                                                                                                                                                                                                                                                                                                                                      |

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|  | §59C(1) or (2) that is not lower than 100% is 150%. Hence, the grade B bank exposure should be allocated a risk-weight of 150% instead of 75%. |
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## 5. **Qualifying non-bank financial institution (“QNBFI”) exposures**

Definition of “qualifying non-bank financial institution” in §2(1)

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| <b>Q17.</b> | <b>It appears that “financial activities” mentioned in paragraph (c) of the definition of QNBFI is not defined in the BCR for the purposes of the STC approach. Would the HKMA define such term in order to enhance clarity?</b>                                                                                                                                                                                                                                                                                                                                                                              |
| A17.        | There is no need to define “financial activities” for the purposes of the definition of QNBFI because each jurisdiction will define what types of financial activity require authorization and supervision. If an AI has an exposure to an entity that carries on certain financial activities in a jurisdiction, the AI is expected to verify whether these financial activities are regulated activities under the law of the jurisdiction. If the financial activities are not regulated activities, the entity is not a QNBFI for the purposes of Part 4 of the BCR.                                      |
| <b>Q18.</b> | <b>In jurisdictions where banks and non-bank financial institutions (including insurance firms and securities firms) are regulated by a single regulator, can AIs assume that those non-bank financial institutions are QNBFI for the purposes of the BCR?</b>                                                                                                                                                                                                                                                                                                                                                |
| A18.        | AIs should not make such assumption because a single regulator may apply different supervisory requirements to different financial sectors based on their specific characteristics and it is possible that some of the supervisory requirements may not be equivalent to those applied to banks.                                                                                                                                                                                                                                                                                                              |
| <b>Q19.</b> | <b>Guidance is sought on how AIs could determine whether the condition set out in paragraph (c)(i) of the definition of QNBFI is met. For example, whether AIs are expected to keep track of the announcements made by the relevant banking supervisory authorities.</b>                                                                                                                                                                                                                                                                                                                                      |
| A19.        | We do not expect that banking supervisory authorities will make an announcement on QNBFI, but the capital requirements issued by the authorities <sup>8</sup> will usually clarify which types of non-bank financial institution in their jurisdictions can be risk-weighted as banks under their capital adequacy requirements. AIs may refer to the capital adequacy requirements of the jurisdictions concerned and the public registers of regulated entities maintained by regulators (e.g. Monetary Authority of Singapore <sup>9</sup> ) for the purposes of paragraph (c) of the definition of QNBFI. |
| <b>Q20.</b> | <b>How to identify whether an entity is a “licensed corporation” under the Securities and Futures Ordinance (“SFO”) or an “authorized insurer” under the Insurance Ordinance?</b>                                                                                                                                                                                                                                                                                                                                                                                                                             |

<sup>8</sup> For example, definition of “institution” in Article 4 point 1 of Regulation (EU) No 575/2013, Part VII, Division 3, Sub-division 1, paragraph 7.3.1(e) of the MAS Notice 637, and paragraph 56 of Chapter 4 of the Capital Adequacy Requirements 2023 issued by the Office of the Superintendent of Financial Institutions, Canada).

<sup>9</sup> <https://eservices.mas.gov.sg/fid>



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| A20.        | The Securities and Futures Commission and the Insurance Authority have maintained public registers that enable the public to verify whether an entity is a licensed corporation or authorized insurer.                                                                                                                                      |
| <b>Q21.</b> | <b>Are entities with temporary licences granted under §117 and §118 of the SFO considered as licensed corporations?</b>                                                                                                                                                                                                                     |
| A21.        | Licensed corporation is defined in section 1 of Part 1 of Schedule 1 to the SFO, which means a corporation that is granted a licence under §116 or §117 of the SFO. Hence, entities with temporary licences granted under §117 of the SFO are also “licensed corporations”.                                                                 |
| <b>Q22.</b> | <b>If at least one subsidiary of a holding company (without any licence to carry on financial activities) is a licensed corporation (other than one that is licensed for Type 10 regulated activity) or bank, can the holding company be classified as QNBFI?</b>                                                                           |
| A22.        | A holding company that does not meet the requirements specified in paragraph (a), (b) or (c) of the definition of QNBFI in §2(1) is not a QNBFI.                                                                                                                                                                                            |
| <b>Q23.</b> | <b>Although currently all entities licensed for Type 10 regulated activity are not licensed for other regulated activities, if in case there is an entity that is licensed for more than one regulated activity (including Type 10 regulated activity), can such entity be classified as QNBFI?</b>                                         |
| A23.        | It is unlikely that an entity will be licensed for Type 10 regulated activity as well as other types of regulated activity as this will usually give rise to the concern of conflict of interest which is one of the issues that triggered enhancements in the regulation of credit rating agencies after the 2008 global financial crisis. |
| <b>Q24.</b> | <b>Will Stored Value Facility (“SVF”) licensees that are under the HKMA’s supervision be regarded as QNBFI under the STC approach?</b>                                                                                                                                                                                                      |
| A24.        | SVF licensees that are not banks will not be regarded as QNBFI under the STC approach because they are not subject to regulatory capital and liquidity requirements that are similar to those imposed on AIs.                                                                                                                               |

#### Treatment of unrated QNBFI exposures

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| <b>Q25.</b> | <b>Given the SCRA set out in §59B and §59C are designed for exposures to banks, guidance is sought on how the SCRA applies to QNBFI, in particular, when the regulatory requirements imposed on QNBFI by relevant regulators may not be easily translated into capital adequacy and countercyclical buffer requirements for banks.</b> |
| A25.        | The credit assessment under the SCRA consists of two major components:                                                                                                                                                                                                                                                                 |

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|             | <p>(a) a credit opinion on the capacity of a QNBFI to meet its financial commitments; and</p> <p>(b) a need to ascertain whether the QNBFI meets or exceeds the minimum regulatory requirements (and buffers if applicable) imposed by its home supervisor.</p> <p>Component (a) is a generic requirement that is applicable to any type of counterparty.</p> <p>For component (b), since financial institutions incorporated outside Hong Kong may be classified as QNBFIs only if they are subject to a regulatory and supervisory framework that is equivalent to that for banks, the minimum regulatory requirements applicable to QNBFIs in a jurisdiction (e.g. minimum capital ratios) and the actual regulatory ratios maintained by individual QNBFIs are expected to be publicly available so that AIs can conduct the assessment in the same manner as in the case of banks. There is no need to translate the ratios into capital adequacy and countercyclical buffer requirements for banks. For example, to qualify for a credit assessment grade of A under the SCRA, the QNBFI concerned must meet or exceed the published minimum regulatory requirements and buffers established by its national supervisor. Hence, an AI only needs to identify what the minimum regulatory requirements and buffers established by the QNBFI's supervisor are and determine whether the actual ratios maintained by the QNBFI meet or exceed those requirements/buffers. If there is no sufficient information for determining whether the QNBFI is qualified for a credit assessment grade of A or B, the QNBFI must be assigned a credit assessment grade of C.</p> <p>In the case of QNBFIs in Hong Kong that are supervised by the Insurance Authority or the Securities and Futures Commission, a risk-weight of 75% (and 50% for short-term exposures (essentially exposures with an original maturity of 3 months or less)) would apply (see §60(4)). In other words, there is no need to assign any credit assessment grade to these QNBFIs.</p> <p>If an AI is uncertain about whether a financial institution is eligible for being classified as a QNBFI, the AI must treat the financial institution as a corporate for capital purposes.</p> |
| <b>Q26.</b> | <b>If for a QNBFI, the CET1 capital ratio and leverage ratio are not available or not applicable, what benchmarks can be used to determine whether the 30% risk-weight under §59C(2) can be allocated to an exposure to the QNBFI?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| A26.        | If the regulatory requirements applicable to a QNBFI do not include a CET1 capital ratio requirement and/or a leverage ratio requirement similar to those applicable to banks, §59C(2) is not applicable to the QNBFI (i.e. the 30% risk-weight is not one of the risk-weights that may be assigned to the QNBFI under the SCRA).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |

## 6. General corporate exposures

### Risk-weights inferred from short-term issue specific ratings

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| Q27. | <p><b>Clarification is sought on whether the following understanding of the requirements set out in §61(3) and (4) is correct:</b></p> <p><b>(a) If—</b></p> <p><b>(i) no issue specific rating is assigned to an exposure to a corporate that is not a small business, but the corporate has an issuer rating or there is a similar debt security issued by the same corporate with a short-term rating; and</b></p> <p><b>(ii) according to Table 5 in §61(1), the issuer rating or the short-term rating of the similar debt security would map to 150% risk-weight,</b></p> <p><b>AI should assign 150% risk-weight to the exposure.</b></p> <p><b>(b) Exposures with an original maturity of one year or less and without issue specific rating should not be risk-weighted below 100%, even if the obligor’s issuer rating or a short-term rating of a reference exposure would map to a risk-weight lower than 100%.</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| A27. | <p>§61(3) and §61(4) apply to an AI’s general corporate exposures to a corporate only if one of the corporate’s debt obligations (including those that are held by other banks/investors) has a short-term issue specific rating.</p> <p><b>(a) According to §61(3), the AI should—</b></p> <p><b>(i) map the short-term issue specific rating of the reference exposure (i.e. the exposure referred to in §61(3)(a)(ii)) to the corresponding ST ECAI rating mapping table to determine the risk-weight that would be applicable based on that short-term issue specific rating and in accordance with §61(1) (see §61(3)(b)); and</b></p> <p><b>(ii) if the risk-weight determined under (i) above is 150%, allocate a risk-weight of 150% to all general corporate exposures to the same corporate that do not have issue specific ratings (i.e. the exposure referred to in §61(3)(a)(i)), regardless of whether the corporate has an issuer rating or not, and whether any of the corporate’s debt obligations has a long-term issue specific rating or not.</b></p> <p><b>(b) If an AI’s general corporate exposure to a corporate (“subject exposure”) has an original maturity of one year or less and the subject exposure does not have an issue specific rating, according to §61(4), the AI should—</b></p> <p><b>(i) map the short-term issue specific rating of the reference exposure (i.e. the exposure referred to in §61(4)(a)(ii)) to the corresponding ST ECAI rating mapping table to determine the risk-weight that would be</b></p> |

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|  | <p>applicable based on that short-term issue specific rating and in accordance with §61(1) (see §61(4)(b));</p> <p>(ii) do either of the following—</p> <ul style="list-style-type: none"> <li>• if the corporate has an issuer rating or another debt obligation of the corporate has a long-term issue specific rating (i.e. one of the situations mentioned in §61(4)(a)(i))—map the issuer rating or long-term issue specific rating, as the case may be, to the corresponding LT ECAI rating mapping table to determine the risk-weight that would be applicable based on that rating and in accordance with §61(1); or</li> <li>• if the subject exposure is an unrated exposure as defined in §51(1) (i.e. another situation mentioned in §61(4)(a)(i))—determine the risk-weight in accordance with §61(2); and</li> </ul> <p>(iii) if the risk-weight determined under (i) above is 50% or 100% and the risk-weight determined under (ii) above is lower than 100% (e.g. 75%), the AI must allocate 100% risk-weight, instead of 75% risk-weight, to the subject exposure.</p> |
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Definition of “small business” in §51(1)

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| <b>Q28.</b> | <b>What is the supervisory expectation on the frequency of the review of a corporate’s annual sales for the purpose of determining whether the corporate is, or remains, eligible for being classified as “small business”?</b>                                                                                                                                                                                                                                                                                                                                                                                      |
| A28.        | <p>AIs are expected to determine the annual sales of a borrower based on the latest information they obtain in their usual credit risk management process (e.g. annual credit review).</p> <p>The annual sales in a financial year should be ascertained through the audited financial report. However, if audited financial reports are not available or not up-to-date, other recent information for that year (e.g. management accounts or internal management reports prepared by the borrower, transaction/payment data) that are considered by AIs as reliable may be used.</p>                                |
| <b>Q29.</b> | <p><b>For retail banking business, term loans and instalment loans may be granted to companies which are not subject to annual credit review. Annual sales information is only obtained in the underwriting process. Clarification is sought on which of the following approaches would be acceptable for the purpose of determining whether a borrower is “small business”:</b></p> <p><b>(a) Option 1: Continue to classify the borrower as “small business” over the loan tenor based on the annual sales information obtained at underwriting (which may not be the latest), unless there is information</b></p> |

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|             | <p>that contradicts this classification coming to the AI's attention obtained in the credit risk management process.</p> <p>(b) <b>Option 2: The borrower is only eligible for being classified as “small business” for the first and second years due to acceptable range of “latest information”, and should then be reclassified as “corporate other than small business” in the absence of more recent figures.</b></p> <p>(c) <b>Option 3: If AIs foresee that more recent annual sales cannot be obtained regularly throughout the loan tenor, the borrower can be classified as “corporate other than small business” even it is qualified for “small business” at loan origination.</b></p>                                                                                                                                                                           |
| A29.        | For cases where the only facility granted to the borrower is a term loan or instalment loan that is not subject to annual credit review, Option 2 and Option 3 are acceptable as they can be accommodated by the relevant requirements under the BCR (see the definition of “small business” in §51(1) and the treatment under §65D(3) of the BCR).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| <b>Q30.</b> | <b>Clarification is sought on whether a SPV/BVI company/shell company without operating activities, i.e. no annual sales value, can be deemed as small business for risk-weighted amount calculation.</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| A30.        | <p>It is supposed that the question refers to—</p> <p>(a) an entity that is not part of a corporate group with operating activities and non-zero annual sales (e.g. the entity is neither the holding company nor a subsidiary of that group); or</p> <p>(b) an entity that is not subject to consolidation under relevant accounting standards.</p> <p>The definition of “small business” in §51(1) of the BCR only captures corporates with annual sales. Hence, an entity without operating activities and therefore without annual sales does not fall within that definition.</p>                                                                                                                                                                                                                                                                                        |
| <b>Q31.</b> | <p><b>The audited financial report of a company as of 31 December, <u>Year 1</u> is usually published in late February of <u>Year 2</u>. As such, an AI has scheduled the annual credit review of the company in March of each year.</b></p> <p><b>Since the CAR return for the position as of <u>31 March</u> has to be submitted in April, but by that time the credit review of the company is not yet completed and therefore the annual sales in the AI's relevant system has not yet been updated (whether based on in-house or audited numbers), is there any flexibility for the AI to use the annual sales of <u>Year 1</u> to determine whether the company is a small business for the CAR return as of <u>31 March, Year 3</u> (although Year 2 is literally “the most recent financial year” specified in the definition of “small business” in §51(1))?</b></p> |

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| A31. | <p>As mentioned in A28, the annual sales of a company in a financial year should be ascertained through the audited financial report or, where updated audited financial report is not yet available, other recent and reliable information for that year.</p> <p>In the absence of more recent figures, using the annual sales reported in the financial report for Year 1 to calculate the AI's capital ratios as of 31 March, Year 3 is still acceptable but using any sales figures in financial years earlier than Year 1 will not be considered as reasonable in general. An AI has the responsibility to obtain the most updated information available from the company for credit assessment.</p> |
| Q32. | <b>In paragraph (b) of the definition of “small business” in §51(1), does “consolidated group” refer to the consolidated group on financial reporting basis?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| A32. | Yes, the understanding is correct.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| Q33. | <b>Is the requirement on timeliness of financial report figures mentioned in A31 also the HKMA's general expectation for asset classes other than “small business”?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| A33. | Under the STC approach, only the definition of “small business” requires AIs to obtain financial information on the most recent financial year of the borrower for capital adequacy purposes. There is no similar requirement for other asset classes.                                                                                                                                                                                                                                                                                                                                                                                                                                                    |

## 7. **Specialized lending exposures**

### Features of specialized lending

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| Q34. | <b>When determining whether a transaction falls within paragraph (b)(i) of the definition of “specialized lending” in §51(1), what is the supervisory expectation on how to confirm the primary repayment source in a case where the obligor is a non-SPV?</b>                                                                                                                                                                                                                                                                                                                                                                                       |
| A34. | AIs are expected to possess the necessary expertise in determining the primary repayment source for a loan or credit facility as this is one of the major parts of a credit assessment for credit decision making. Hence, AIs can make use of their usual credit assessments for classification purpose in relation to specialized lending. The distinct feature of specialized lending is that the borrower, among other things, has little or no independent capacity to repay the exposure concerned. In other words, the cash flow generated by the asset(s) being financed is the sole or almost exclusive source of repayment of the exposure. |

### Object finance

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| Q35. | <b>What types of transactions are generally regarded as object finance?</b>                                                                                                      |
| A35. | Object finance is a transaction for financing the acquisition of physical asset(s) (e.g. satellites, ships, aircrafts, railcars and fleets), and the primary source of repayment |

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|             | <p>of the loan concerned is the cash flows generated by the asset(s) being financed. These cash flows could be from rental or lease contracts entered into with one or more third parties.</p> <p>If the borrower has the ability to repay the loan without undue reliance on the cash flows generated by the asset(s) being financed and the lending AI has recourse to the borrower for repayment of the loan, the loan should be treated as a corporate exposure rather than as specialized lending.</p>                                                                                                                                                                                                                                                                  |
| <b>Q36.</b> | <b>If an AI owns a ship or aircraft that is directly leased to a shipping company or airline without a lessee-owned SPV and the AI has recourse to the shipping company or airline for payment, may the AI classify such operating lease as specialized lending - object finance?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| A36.        | According to the definition of “specialized lending” in §51(1), one of the characteristics of specialized lending is that the primary source of repayment of the exposure is the income generated by the <u>asset(s) being financed</u> by the lender, either <u>in legal form or economic substance</u> . The AI may classify the operating lease as specialized lending if the lease possesses the above characteristic and the other characteristics specified in the definition (also see Q35 above).                                                                                                                                                                                                                                                                    |
| <b>Q37.</b> | <b>Would an exposure (other than an operating lease) to a non-SPV with indication that the primary repayment is based on the asset(s) being financed be classified as specialized lending – object finance?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| A37.        | <p>In order for an exposure to be classified as specialized lending – object finance, the exposure must possess the required characteristics set out in the definitions of “specialized lending” and “object finance” in §51(1), either in legal form or economic substance (also see Q34, Q35 and Q36). Hence, an AI should determine whether the exposure falls within the above definitions based on its assessment of the particularities of the obligor and the exposure. To avoid doubt, the obligor in respect of object finance does not need to be an SPV and the form of financing does not need to be operating lease.</p> <p>AIs are expected to put in place systems and controls to ensure that their classification is reliable and consistent over time.</p> |

#### Commodities finance

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| <b>Q38.</b> | <b><sup>10</sup>What are the typical features of transactions that are eligible for being classified as commodities finance?</b>                                                                                                                                |
| A38.        | An eligible transaction is self-liquidating in nature (i.e. the commodity financed by the loan concerned will be sold to repay the loan) and the structure of the transaction is designed to compensate for the weak credit quality of the borrower because the |

<sup>10</sup> Reference: Page 6 of “Working paper on the internal ratings-based approach to specialised lending exposures” issued by the BCBS in October 2001.

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|  | <p>borrower has no independent capacity to repay the loan. For example, a bank extends a short-term documentary credit to a small independent trading company that acts as an intermediary between producers of commodities and their customers. Each commodity shipment handled by the trading company is financed and secured separately. Credit is extended by the bank upon delivery of the commodity (e.g. corns) to the trading company, who has already contracted for the resale of the commodity. A trust-worthy third party controls the shipment of the commodity, and the bank controls payment by the customer.</p> <p>If the borrower has cash flows generated from other business activities that can be used to repay the loan and the lending AI has recourse to the borrower for the repayment, the loan should be treated as a corporate exposure rather than as commodities finance.</p> |
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### Project finance

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| <b>Q39.</b> | <b><sup>11</sup>What are the typical features of transactions that are eligible for being classified as project finance?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| <b>A39.</b> | <p>Project finance is usually for financing large, complex and expensive installations, such as power plants, chemical processing plants, mines, transportation infrastructure, and telecommunication infrastructure. This type of financing may take the form of financing of the construction of a new installation, or refinancing of an existing installation (with or without improvements).</p> <p>The lender is usually paid solely or almost exclusively out of the cash flows generated by the contracts for the installation's output, such as the electricity sold by a power plant, and the borrower is usually an SPV established solely for developing, owning and operating the installation. As such, the repayment of the loan concerned depends primarily on the project's cash flows and the value of the project's assets.</p> <p>In contrast, if the loan depends primarily on a well-established and credit-worthy corporate for repayment (e.g. a loan to finance the installation of transatlantic fibre optic cable where the borrower is an established telecommunications firm with diversified revenue stream, i.e. the repayment ability of the borrower does not depend primarily on the performance of the new installation being financed), the loan should be treated as a corporate exposure rather than as specialized lending - project finance.</p> <p>Loans that are for financing the development or acquisition of real estates (e.g. industrial buildings to let or for sale) should be classified as real estate exposures rather than as specialized lending - project finance.</p> |

<sup>11</sup> Reference: Page 3 of "Working paper on the internal ratings-based approach to specialised lending exposures" issued by the BCBS in October 2001.



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| <b>Q40.</b> | <b>If an AI granted a loan to a corporate to construct a tunnel primarily based on a guarantee given by the holding company of the corporate rather than the toll income to be generated from that tunnel, is the loan a project finance?</b>                                                                                                                                                                                 |
| <b>A40.</b> | Such loan would not fall within the definition of “specialized lending” if— <ul style="list-style-type: none"> <li>(a) the AI is of a view that the tunnel’s cash flows alone may not be sufficient to repay the loan; and</li> <li>(b) the AI’s credit decision is based primarily on the guarantor’s obligations under the guarantee and its capacity to repay the loan in the event of default of the borrower.</li> </ul> |

### High quality project finance

#### *(a) Climate-related financial risk*

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| <b>Q41.</b> | <b><sup>12</sup>To what extent does the classification as high quality project finance require consideration of climate-related financial risks?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| <b>A41.</b> | <p>Changes in environmental policy, technological progress or investor sentiment can leave projects exposed to transition risks. At the same time, projects may be exposed to physical risks depending on their type and location.</p> <p>When assessing the ability of a project finance entity to meet its financial commitments in a timely manner, AIs are expected to, on a best effort basis given the challenges arising from, for example, methodological and data limitations that cannot be fully resolved currently—</p> <ul style="list-style-type: none"> <li>(a) consider the extent to which climate-related financial risks may have an adverse impact on the ability of a project finance entity to meet its financial commitments in a timely manner; and</li> <li>(b) in view of uncertainty of the materiality and timing of the impact of climate-related financial risks, evaluate on an ongoing basis the impact of climate-related financial risks as the capacity to evaluate climate-related financial risk data improves.</li> </ul> <p>The HKMA will adopt a pragmatic approach and apply the proportionality principle in line with the implementation approach of SPM GS-1 “Climate Risk Management”.</p> |
| <b>Q42.</b> | <b>Project finance might be relevant to financing transition to a lower carbon intensive infrastructure or other similar green project. Would the HKMA consider providing supplementary and indicative reference to the relevant sector that might or would be considered eligible for being treated as high quality project finance, with reference in particular to the classification scheme</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |

<sup>12</sup> Reference: FAQ inserted into Basel Framework CRE20.52.

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|      | <b>introduced with the HKMA “Hong Kong Taxonomy for Sustainable Finance” published in May 2024?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| A42. | For the purposes of capital calculation, “high quality” is in terms of the project entity’s financial capability to meet financial commitments and the degree of protection to creditors provided by the terms and conditions of the project documents and loan documents. Since transition to a lower carbon intensive infrastructure (or the level of “greenness”) does not guarantee financial sustainability of the project concerned, green-related projects, regardless of whether they are related to or fall within the economic activities encompassed in the Hong Kong Taxonomy, should also be assessed against the same criteria as set out in §62(3). |

*(b) §62(3)(d) - revenues*

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| <b>Q43.</b> | <b>Does §62(3)(d) only apply to cash flows that are availability-based or subject to a rate-of-return regulation or take-or-pay contract and that are used to amortize 100% of the term debt?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| A43.        | There is no such requirement, but it is understood that the cash flows are the primary source of repayment of the project finance.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <b>Q44.</b> | <b>For contracts that contain both availability-based/rate-of-return regulation related/take-or-pay cash flows (“concerned cash flows”) and non-contracted cash flows, is there any materiality qualifier on the percentage of debt that should be repaid by the concerned cash flows in order to fulfil §62(3)(d)?</b>                                                                                                                                                                                                                                                                                                                                                                                             |
| A44.        | <p>As the types of facility granted under a project finance may be in various forms and there may not be a fixed ratio between revenues and repayment amounts during the whole term of the project finance, it does not seem feasible to set any hard limit. The principle is that the primary source of repayment must be revenues that are availability-based or subject to a rate-of-return regulation or take-or-pay contract.</p> <p>The underlying rationale of §62(3)(d) is that there should be a stable income source that enables the project finance entity to meet its financial commitments in a timely manner, even when there are adverse changes in the economic cycle and business conditions.</p> |

*(c) §62(3)(e) - main counterparty*

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| <b>Q45.</b> | <b>If a project has multiple off-takers and the revenues from them in aggregate contributes the majority of the project’s total revenue, could §62(3)(e) be regarded as being met on a combined basis?</b> |
| A45.        | In §62(3)(e), “one main counterparty” means a single legal entity instead of a group of counterparties considered on a collective basis.                                                                   |

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| Q46. | <b>Does “main counterparty” refer to the off-taker that contributes the highest percentage of revenue in a project even though the amount contributed is less than 50%?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| A46. | The underlying yardstick is that the revenue of the project finance entity generated from the main counterparty should enable the project finance entity to meet its financial commitments in a timely manner, even when there are adverse changes in the economic cycle and business conditions.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| Q47. | <p><b>Clarification is sought on whether the following scenarios can be considered as fulfilling §62(3)(e) (in other words, whether all projects with more than one off-taker would be ineligible for being classified as high quality project finance, irrespective of their underlying risk profile)—</b></p> <p>(a) <b>a project with multiple off-takers where the total revenues from these off-takers account for a majority of the project’s revenue;</b></p> <p>(b) <b>there are 3 off-takers that contribute 40%, 30% and 30% of the project’s total revenues respectively, and the off-taker with 40% contribution is an investment group.</b></p>                                                                                                                                                                                                                                                                        |
| A47. | <p>(a) There is no requirement in §62(3) that there must be only one counterparty. Hence, projects with more than one off-taker will not be disqualified automatically. For a project with more than one off-taker, §62(3)(e) reflects the requirements in CRE20.52(4) of the Basel Framework that—</p> <p>(i) the project finance entity’s revenue should depend on one main counterparty (in other words, the other off-takers are not the major source of revenue of the project); and</p> <p>(ii) this main counterparty should be a central government, PSE or a corporate, that has a risk-weight of 80% or lower.</p> <p>(b) In such scenario, AIs should consider whether the project finance entity is still able to meet its financial commitments in a timely manner if any one or more of the off-takers default. Hence, the decision is not just based on the percentage of revenue contributed by each off-taker.</p> |

*(d) §62(3)(g) - protection against losses resulting from termination of project*

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| Q48. | <b>A project can be terminated due to a variety of reasons including force majeure, inefficiency of the project finance entity to generate revenue, etc. Also, the pay-out of the counterparties or off-takers is based on the reason of project termination and they usually do not provide blanket security that covers all scenarios of project termination. Would more details be provided on the project termination scenarios being considered for §62(3)(g)?</b> |
| A48. | §62(3)(g) is equivalent to CRE20.52(6) of the Basel Framework, which is one of the typical features of public-private partnership availability-based projects that,                                                                                                                                                                                                                                                                                                     |

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|             | <p>according to ECAIs' default studies, exhibit lower risk profile. Termination in this case refers to a termination during the operational phase triggered by an event (other than borrower default) defined in the project documentation ("relevant termination event"). Since no particular termination event is specified in CRE20.52(6), it is reasonable to conclude that the contractual provisions of a high quality project should provide for termination compensation that cover all relevant termination events.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| <b>Q49.</b> | <p><b>Clarification is sought on the application of §62(3)(g) to projects like the following:</b></p> <p><b>(a) a power project where all power can only be sold to a government-owned company, and it is not possible to find a replacement off-taker; and</b></p> <p><b>(b) a power project where all power is sold to a single private company. In case that company terminates the off-take contract with the project company, the project company can still find an alternative buyer for its output or sell the power in the merchant electricity market. There is usually a 6-month grace period (which can be extended further with lenders' consent) for the project company to find an alternative buyer. During the grace period, lenders can rely on the sales in the merchant electricity market or the Debt Service Reserve Account for payment of the loan instalments due.</b></p>                                                                                                                                                                                                                                                                                                                                                                                         |
| <b>A49.</b> | <p>§62(3)(g) requires that there must be a person that will protect the creditors from losses due to a termination of the project. Such person does not need to be the main counterparty. It can also be a counterparty which similarly complies with the eligibility criteria for the main counterparty.</p> <p>In (a), the requirement of §62(3)(g) is met if the government (provided that its risk-weight is 50% or lower) or the government-owned company (provided that it is a PSE or a corporate with a risk-weight of 80% or lower) will protect the creditors from the losses resulting from a termination of the power project.</p> <p>In (b), the termination of the off-take contract with the private company is not necessarily equal to the termination of the project since the project will continue when a replacement off-taker is found. If it is possible that the termination of off-take contract will lead to a termination of the project, the key consideration is whether contractually the private company or another high quality party will protect the creditors from losses due to the termination of the project. Since a replacement off-taker is not guaranteed, this will not be regarded as termination protection for the purpose of §62(3)(g).</p> |
| <b>Q50.</b> | <p><b>It appears that §62(3)(g) contradicts the definition of "specialized lending" in §51(1) that requires the primary source of repayment to be the income generated from the project. If the main counterparty undertakes to recuperate all the losses incurred by the creditors due to project termination, the underlying credit risk is changed from the project's revenue generating</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |

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|      | <b>capability to the credit worthiness of the main counterparty. Clarification is sought in this regard.</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| A50. | Paragraph (b)(i) of the definition of “specialized lending” in relation to the primary source of repayment is a feature that helps AIs to determine whether an exposure should be classified as specialized lending for risk-weighting purposes. The risk-weights for specialized lending are intended to reflect a series of factors including the protection available to creditors when the asset/assets fail to generate sufficient cash flows for loan repayments. Termination compensation can be considered as a form of risk mitigant that partly contributes to the lower risk-weight of 80%. |

*(e) §62(3)(h) - assets pledged*

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| <b>Q51.</b> | <b>In §62(3)(h)—</b><br><br><b>(a) does “all assets and contracts necessary” refer to all key assets indispensable for operating the project?</b><br><br><b>(b) does “have been pledged (or otherwise provided as security)” refer to having appropriate restrictions in place to ensure that the assets and contracts cannot be pledged to other creditors?</b>                                                                                                                                                                                                                                                                                                                        |
| A51.        | (a) The full requirement set out in §62(3)(h) is “all assets and contracts <u>necessary to operate the project</u> ” (emphasis added). The word “necessary” has its usual dictionary meaning. AIs should conduct the assessment based on this requirement. Also see Q52.<br><br>(b) The wording “have been pledged (or otherwise provided as security)” does not mean a negative pledge clause or other measure with a similar effect. The requirement essentially means that the lending parties (including the AI concerned) must have a legally enforceable security interest in the assets and contracts concerned, created through, for example, first legal charge or assignment. |
| <b>Q52.</b> | <b>In certain projects, providing the project assets to the lenders as collateral is not prohibited by law, but it is not practically possible to do so due to the nature of the assets (e.g. road, prisons, hospitals, etc.). Would these projects be regarded as failing to meet the condition set out in §62(3)(h)?</b>                                                                                                                                                                                                                                                                                                                                                              |
| A52.        | Assets in this context do not need to be physical assets (e.g. the road in a toll road project). If it is a standard practice in a particular type of project that the physical assets will not be pledged to the creditors, the HKMA would not consider it unreasonable to regard the requirement in §62(3)(h) as being met if the assets and contracts that have been pledged to the creditors are already sufficient in providing the creditors with step-in rights and the ability to protect key contracts/assets and enforce the terms of key project agreements (e.g. the concession agreement).                                                                                 |

## 8. Retail exposures

### Regulatory retail exposure

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| <b>Q53.</b> | <b>Should “other real estate exposure” secured by residential properties be excluded when calculating the aggregate exposure for the purpose of determining whether §64(2)(d) and (e) are met?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| <b>A53.</b> | <p>In calculating the aggregate exposure, all forms of exposures (<u>including</u> real estate exposures secured by non-residential properties but <u>excluding</u> real estate exposures secured by residential properties) must be aggregated.</p> <p>Real estate exposures secured by residential properties mentioned in §64(3)(a) mean exposures falling with the definition of “real estate exposure” in §51(1) where the immovable property concerned is a residential property. In other words, all real estate exposures secured by residential properties (regardless of whether they are regulatory real estate exposures) are excluded from the calculation of the aggregate exposure.</p> |

### Transactor

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| <b>Q54.</b> | <b>Should “over limit” commitment from credit cards within tolerance level be regarded as overdraft for the purposes of the definition of “transactor” in §2(1)?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| <b>A54.</b> | Since the “over limit” commitment is an integral part of a credit card facility granted to a customer, it is not regarded as an overdraft for the purpose of determining whether the customer is a transactor.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| <b>Q55.</b> | <b>For the purposes of the definition of “transactor” in §2(1), are redrawable loans and loans on cards (e.g. balance transfer, instalment loan on card) revolving facilities?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| <b>A55.</b> | <p>(a) Instalment loans where the repaid principals can be redrawn are treated as non-revolving loans instead of revolving facilities.</p> <p>(b) Loans on cards will be regarded as outstanding balances under revolving facilities if all the following conditions are met—</p> <ul style="list-style-type: none"> <li>(i) the loan is granted under the borrower’s credit card limit;</li> <li>(ii) if the loan is an instalment loan, each monthly instalment amount is billed to the borrower’s credit card account monthly. An instalment amount is treated in the same way as a purchase transaction and included as part of the credit card monthly statement balance;</li> <li>(iii) if the loan is not an instalment loan, the whole loan amount is billed to the borrower’s credit card account and treated in the same way as a</li> </ul> |

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|             | <p>purchase transaction. Any outstanding balance of the loan will be included as part of the credit card monthly statement balance;</p> <p>(iv) in the cases mentioned in subparagraphs (ii) and (iii) above, the borrower has an option to pay only a minimum payment due; and</p> <p>(v) such minimum payment due is calculated by using the same method as that for retail purchases.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| <b>Q56.</b> | <p><b>As regards the condition set out in A55(b)(v), clarification is sought on the meaning of “same method as that for retail purchases” and how that paragraph should be applied for the following products—</b></p> <p><b>(a) cash advance instalment plan under existing credit card limit;</b></p> <p><b>(b) merchant instalment plan or spending instalment plan under existing credit card limit;</b></p> <p><b>(c) additional line of credit granted under the total credit card limit; and</b></p> <p><b>(d) balance transfer or balance consolidation.</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| <b>A56.</b> | <p>The “Minimum Payment” set out in the monthly credit card statement is usually calculated as the higher of—</p> <p>(a) a fixed amount (e.g. HKD230); and</p> <p>(b) the sum of—</p> <p>(i) a fixed percentage (e.g. 1%) of the total outstanding balance of the transactions (other than transactions that are subject to subparagraph (ii) below) shown in the statement; and</p> <p>(ii) the full amounts of other outstanding payments such as fees and charges.</p> <p>In A55(b)(v), “same method” means that—</p> <ul style="list-style-type: none"> <li>▪ in the case of cash advance instalment plan or merchant or spending instalment plan, or balance transfer or balance consolidation that is an instalment loan, the whole monthly instalment is included as part of the total outstanding balance used in the calculation referred to in paragraph (b)(i) above; and</li> <li>▪ in the case of additional line of credit, or balance transfer or balance consolidation that is not an instalment loan, the whole outstanding balance under such facility is included as part of the total outstanding balance used in the calculation referred to in paragraph (b)(i) above.</li> </ul> <p>(See <a href="#">Annex 1</a> for an illustrative example)</p> <p>If the whole monthly instalment of an instalment loan, or the whole outstanding balance of a line of credit or balance transfer/consolidation loan, is subject to</p> |

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|             | paragraph (b)(ii) rather than paragraph (b)(i), the line of credit or loan must not be regarded as revolving facilities.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <b>Q57.</b> | <p><b>According to paragraph (a)(i) of the definition of “transactor” in §2(1), an obligor should have repaid in full the balance due under the facility concerned at each scheduled repayment date for the previous 12 months.</b></p> <p><b>If, under a credit card facility granted by an AI to a customer, there is one late payment record during the previous 12 months purely due to unpaid annual fee, and such annual fee (and the resultant late charge, if any) was subsequently waived by the AI, may the AI treat the obligor as “transactor”?</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| <b>A57.</b> | <p>If—</p> <ul style="list-style-type: none"> <li>(a) the customer only refused to pay the annual fee (and any resultant late charge) but repaid the balances of other billed transactions on or before the due date;</li> <li>(b) the AI subsequently waived the annual fee and any resultant late charge; and</li> <li>(c) the AI is not aware of any evidence suggesting an increase in credit risk of the customer,</li> </ul> <p>it is acceptable to regard the customer as having repaid in full the balance due for the purpose of identifying transactors under the BCR.</p> <p>Similarly, if the annual fee was waived by the AI on or before the due date and the customer only paid an amount that was equal to the difference between the statement balance and the annual fee, the AI may regard the customer as having repaid in full the balance due.</p> <p>The same principle also applies to other bank charges or fees payable by customers for other types of revolving facility.</p> |

## 9. Unhedged credit exposure

### Non-revolving loans versus revolving facilities

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| <b>Q58.</b> | <b>Is the currency mismatch multiplier applicable to exposures under revolving facilities (e.g. revolving loans, overdrafts, loan on cards) given that such exposures may have features similar to pre-designated principal and interest repayment schedules?</b> |
| <b>A58.</b> | Subject to any further guidance or clarifications from the Basel Committee, all revolving facilities are excluded. Please refer to the definition of “revolving” in §2(1), and Q59, Q60 and Q61 below.                                                            |
| <b>Q59.</b> | <b>For the purposes of §51A(1) (meaning of unhedged credit exposure), are redrawable loans and loans on cards revolving facilities?</b>                                                                                                                           |



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| A59.        | Please see Q55 and Q56.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| <b>Q60.</b> | <b>If a borrower is allowed to draw down a fixed rate loan under an uncommitted revolving facility, and the borrower can choose when to repay and the amount to be repaid, also, any unpaid portion of the loan at maturity will be charged at overnight interest rate as an overdraft and the AI concerned has the right to recall the loan at any time, is such loan part of a revolving facility?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| A60.        | Any amount drawn under a revolving facility will not be regarded as a separate non-revolving loan for the purpose of the definition of “unhedged credit exposure”, unless the drawn amount is in economic substance a term loan that meets the description of paragraph (b) of the definition of “unhedged credit exposure” in §51A(1).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| <b>Q61.</b> | <b>In the case of retail exposures, are there any intended differences between “instalment loans” and “non-revolving loans with pre-specified schedules of repayment”?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| A61.        | <p>Non-revolving loans, according to paragraph (b) of the definition of “unhedged credit exposure” in §51A(1), are loans—</p> <ul style="list-style-type: none"> <li>(i) with a pre-specified schedule of repayments of principal and interest (which does not need to be regular monthly repayments) and predefined repayment amounts such that the whole loan amount will be repaid within a fixed repayment period, including such a loan that allows re-borrowing of the repaid principal (whether there is an extension of the fixed repayment period or not); or</li> <li>(ii) that will be repaid within a fixed repayment period with a bullet payment.</li> </ul> <p>Since instalment loan also falls within paragraph (b) of the definition of “unhedged credit exposure”, there is no reference to “instalment loan” in §51A. “Instalment loan” is typically considered as a loan the whole loan amount of which must be repaid in regular monthly amounts (each payment is made up of both principal and interest) within a fixed repayment period. The most common example is mortgage loans that finance acquisition of real estates.</p> |
| <b>Q62.</b> | <p><b>Clarification is sought on whether the following margin lending facility is subject to the currency mismatch multiplier:</b></p> <ul style="list-style-type: none"> <li><b>(a) the margin lending facility is fully collateralized and mark-to-market is conducted on a regular basis;</b></li> <li><b>(b) the customer can draw multiple term loans under the facility with tenors between 1 to 12 months subject to the total outstanding amounts not exceeding the approved total credit limit; and</b></li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |

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|             | <b>(c) the term loans are allowed to be rolled-over upon maturity or can be repaid fully or partially as per the customer's instruction at any point of time.</b>                                                                                                                                                                                                                                                                                                                                                                             |
| A62.        | Subject to any further guidance or clarifications from the Basel Committee, a margin lending facility is not subject to the currency mismatch multiplier if the facility is a revolving facility. The loan drawn under the margin lending facility is not subject to the currency mismatch multiplier if the loan does not fall within paragraph (b) of the definition of “unhedged credit exposure” in §51A(1).                                                                                                                              |
| <b>Q63.</b> | <b>Would private bank and wealth-based lending be exempted from the currency mismatch multiplier?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| A63.        | There is no presumption that private bank and wealth-based/Lombard lending refer to revolving loans/facilities only. Hence, any private bank or wealth-based/Lombard lending that falls within paragraph (b) of the definition of “unhedged credit exposure” in §51A(1) should be subject to the currency mismatch multiplier.                                                                                                                                                                                                                |
| <b>Q64.</b> | <b>Are facilities with repayment methods different from traditional instalment loans considered in-scope for the currency mismatch multiplier? For example—</b><br><br><b>(a) a secured facility with interest-only repayment, i.e. the obligor repays interest on a monthly basis but is not allowed to redraw the approved limit of the facility; and</b><br><br><b>(b) a secured facility with yearly repayment of principal and monthly repayment of interest.</b>                                                                        |
| A64.        | According to paragraph (b) of the definition of “unhedged credit exposure” in §51A(1)—<br><br>(a) subject to any guidance that may be issued by the Basel Committee from time to time, the facility with interest-only repayment is not subject to the multiplier unless there is a fixed repayment date on which the obligor is required to repay the whole outstanding loan balance (i.e. a bullet payment); and<br><br>(b) the facility with yearly repayment of principal and monthly repayment of interest is subject to the multiplier. |

#### Source of income

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| <b>Q65.</b> | <b>Does “the currency of the obligor’s source of income” in paragraph (c)(i) of the definition of “unhedged credit exposure” in §51A(1) refer to the currency at the time of reporting?</b> |
| A65.        | In the case of credit facilities that are not subject to periodic credit reviews but have regular scheduled repayments of principal and interest (such as regulatory                        |

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|             | <p>residential real estate exposures, including refinancing loans and top-up loans), an AI may continue to rely on the information obtained at loan origination to determine the currency of the obligor's source of income unless the AI is aware of a change in the currency of the obligor's source of income.</p> <p>In the case of other types of credit facility that are subject to periodic credit reviews based on updated information provided by obligors, AIs are expected to verify whether there is any change in the currency of an obligor's source of income as part of a credit review.</p> <p>Also see Q80 for more information.</p>                                                                                                                                                                                                                                |
| <b>Q66.</b> | <b>If an AI does not have sufficient information to verify the currency of an obligor's income, is the AI allowed to regard the currency of the place of residence of the obligor as the currency of the obligor's income?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| A66.        | <p>As provided for under §51A(4), if an AI does not have readily available or sufficient information to assess whether there is a currency mismatch between the exposure and the obligor's source of income, either one of the following treatments will apply—</p> <ul style="list-style-type: none"> <li>(a) for loans granted by the AI <u>before</u> 1 January 2025 ("cut-off date"), the AI may assume that there is no currency mismatch unless the AI has recent information that suggests otherwise; or</li> <li>(b) for loans granted by the AI <u>on or after</u> the cut-off date, the loan must be regarded as having currency mismatch if— <ul style="list-style-type: none"> <li>(i) the place of residence of the borrower is jurisdiction A; and</li> <li>(ii) the loan is denominated in a currency other than the currency of jurisdiction A.</li> </ul> </li> </ul> |
| <b>Q67.</b> | <p><b>Clarification is sought on whether the following situations are considered as "does not have readily available or sufficient information" for the purposes of §51A(4):</b></p> <ul style="list-style-type: none"> <li><b>(a) There is no sufficient information on the currency of the obligor's source of income, and the obligor has not declared that all the sources of income are in HKD.</b></li> <li><b>(b) The currency of the obligor's source of income is not captured by the application/system under current design.</b></li> <li><b>(c) In the current loan application process, the currency of the obligor's source of income is not required.</b></li> </ul>                                                                                                                                                                                                    |
| A67.        | <p>In situation (a), an AI may rely on §51A(4)(a) or (b), as applicable, if the AI has already made reasonable efforts to obtain the information from the obligor but the information is still unavailable.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |

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|             | <p>In situation (b), AIs have the responsibility to enhance their systems to enable capturing information necessary for compliance with the requirements set out in the BCR.</p> <p>In situation (c), similar to situation (b), AIs are expected to adjust the loan application process to require information on the currency of the obligor's source of income.</p> <p>In both situations (b) and (c), AIs may, before completion of the enhancement in the system and/or application process for capturing information on borrowers' currencies of incomes, rely on §51A(4)(a) or (b), as applicable, for the purpose of determining whether there is currency mismatch. AIs are expected to complete the enhancement within a reasonable timeframe (usually no later than 12 months from 1 January 2025). For exposures granted before that date, the AIs may continue to rely on §51A(4)(a) after the enhancement unless there is new information available to the AIs (see Q80).</p> |
| <b>Q68.</b> | <b>If an obligor has multiple sources of income in different currencies, which of the currencies should be regarded as the currency of the obligor's source of income?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| <b>A68.</b> | As required by §51A(2), if an obligor has sources of income in two or more currencies (say HKD, CNY and USD), an AI must regard an exposure to that obligor as falling within paragraph (c) of the definition of "unhedged credit exposure" (regardless of the currency in which the exposure is denominated), i.e. must assume that there is a mismatch between the currency of the exposure and the currency of the obligor's source of income.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |

#### Determination of applicability of currency mismatch multiplier

##### *(a) Pegged currencies*

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| <b>Q69.</b> | <b>Can pegged currencies, such as HKD and USD, be considered as the same currency for the purposes of the currency mismatch multiplier?</b> |
| <b>A69.</b> | Pegged currencies must be considered as different currencies.                                                                               |

##### *(b) Initial assessment*

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| <b>Q70.</b> | <b>For customers with incomes in multiple currencies, if an AI uses the dominant currency (e.g. the currency that accounts for 90% of the customer's total income) to compare with its exposure to the customer instead of comparing each currency against the exposure, is this approach acceptable?</b>                       |
| <b>A70.</b> | When considering whether there is a natural hedge for the exposure, the currencies of other sources of income may need to be considered. For example, if the monthly instalment of a personal loan is HKD50,000 and the borrower's monthly income consists of HKD60,000 and CNY100,000, there is currency mismatch based on the |

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|             | <p>dominant source of income but there is a natural hedge for the HKD instalment and therefore the currency mismatch multiplier is not applicable to the loan.</p> <p>In practice, the AI may take a shortcut in this case by comparing the HKD instalment amount with the amount of the HKD income of the borrower. This will not be considered as a contravention of the requirement of the BCR as the BCR are not meant to dictate, in practice, what steps, or the order of the steps, taken by AIs to determine whether the currency mismatch multiplier is applicable.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| <b>Q71.</b> | <b>For cases where the credit assessment of an exposure does not depend on the income of the borrower, how should an AI assess whether the currency mismatch multiplier is applicable to the exposure?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| <b>A71.</b> | <p>If an AI does not have sufficient information to verify the currency of a borrower's income (including cases where the credit assessment does not require income proof from the borrower), the AI should apply the treatment set out in §51A(4)(a) or (b), as applicable, to the exposure concerned. To avoid doubt, collateral provided by and assets belonging to the borrower cannot be regarded as income for the purpose of determining whether there is currency mismatch, but they can be considered as natural hedges (please see Q86 to Q89 for details).</p> <p>For wealth-based lending, an AI (assuming its relevant underwriting practice is prudent) may regard any acceptable financial assets (see Q87) denominated in the same currency as the exposure concerned as a natural hedge to determine whether the currency mismatch multiplier should be applied.</p> <p>In the case of collateralized lending (including Lombard lending) where information on the borrower's income is unavailable and the collateral is not recognized collateral, the collateral may be regarded as a natural hedge only if the collateral is an acceptable financial asset (see Q87) denominated in the same currency as the exposure concerned.</p> |
| <b>Q72.</b> | <b>If, for innovative retail products (e.g. the New Personal-Lending Portfolio), customers are not required to provide any income proof and AIs will estimate customers' incomes by using models, how should the AIs determine whether the currency mismatch multiplier is applicable?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| <b>A72.</b> | <p>Subject to any guidance that may be issued by the Basel Committee from time to time, for such type of exposures that are granted based on alternative data and/or income estimation models instead of income proof, the currency of the obligor's income would be regarded as HKD if the data collected and/or the model-estimated income is in HKD. Similarly, if the data collected and/or the model-estimated income is in a currency other than HKD, the currency of the obligor's income would be regarded as that other currency.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| <b>Q73.</b> | <b>If there is a CNY mortgage loan with joint borrowers where the salaries of the borrowers are in HKD but one of the borrowers receives CNY rental income and has been granted a CNY personal instalment loan, please clarify how an obligor-level assessment of the applicability of the currency mismatch multiplier to the two loans should be conducted.</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |

|      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
|------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| A73. | <p>In such case—</p> <p>(a) the CNY rental income should be applied to the CNY personal instalment loan first; and</p> <p>(b) the CNY natural hedge available to the CNY mortgage loan is the CNY rental income less 90% of the instalment amount of the CNY personal instalment loan.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| Q74. | <p><b>In practice, an obligor may have two or more facilities in a currency set but the obligor's income in the same currency set is only sufficient to cover partially the repayments of these facilities. In considering whether the facilities are hedged or unhedged, is it correct that the assessment should be based on facility level, in other words, whether the facilities are regarded as hedged if 90% or more of them are covered by income in the same currency set as that of the facilities?</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| A74. | <p>When assessing whether the exposures are sufficiently hedged, the total of the instalment payment amounts of the exposures that are denominated in a particular currency should be compared to the amount of the borrower's income that is also denominated in that currency. Each currency should be assessed separately.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| Q75. | <p><b>If there are 3 income based facilities and 2 asset based facilities, should the 3 income based facilities be considered as one group and the 2 asset based facilities as another group, and the currency mismatch and the total of the instalment payment amounts mentioned in the answer to Q74 be determined separately for each group?</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| A75. | <p>(a) When assessing whether there is currency mismatch, only the currencies of the borrower's source of income and the loans concerned are considered (also see Q66 and Q68 above for cases where there is insufficient or no readily available information to assess the currency of the borrower's income, or where the borrower's income is in multiple currencies). Grouping at this stage may not be necessary.</p> <p>For loans with currency mismatch (i.e. being deemed as such under §51A(2) or when the currency of the borrower's source of income is different from the currency of the loan), an AI needs to further assess whether the loans are unhedged. For such purpose, the approach of assessing the 3 income based facilities as a group separately from the group of the 2 asset based facilities is acceptable, provided that the same financial hedge or natural hedge is not counted twice (e.g. if the borrower's income is already counted in the assessment for the group of income based facilities, the same income must not be counted again in the assessment of the group of the asset based facilities).</p> <p>However, if any one of the facilities is a collateralized loan where the AI is not entitled to apply freely the proceeds from the disposal of the collateral concerned to settle other amounts owed to the AI by the borrower, the AI should treat the collateralized loan and the collateral as a group separated from other collateralized facilities. In other words, the collateral cannot be treated as the natural hedge for other collateralized facilities and unsecured facilities</p> |

|                                                                                      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |                     |                       |                       |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
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|                                                                                      | <p>granted to the borrower.</p> <p>(b) Based on the grouping approach discussed above, in general—</p> <p>(i) all instalment amounts and bullet payments of the loans within the same group in a currency should be aggregated;</p> <p>(ii) similarly, all financial hedges and natural hedges for the loans referred to in subparagraph (i) in the same currency should be aggregated and compared with the aggregate amount obtained under that subparagraph.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |                     |                       |                       |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| Q76.                                                                                 | <p><b>Clarification is sought on whether the following approach to maximizing natural hedge coverage is acceptable.</b></p> <p><b>Borrower’s monthly income:</b> HKD 100, CNY 5</p> <p><b>Acceptable financial asset A (free of encumbrance):</b> HKD 500</p> <table><tr><td></td><td><b>Loan 1</b></td><td><b>Loan 2</b></td><td><b>Loan 3</b></td><td><b>Loan 4</b></td></tr><tr><td><b>Nature</b></td><td><b>Unsecured</b></td><td><b>Wealth based</b></td><td><b>Collateralized</b></td><td><b>Collateralized</b></td></tr><tr><td><b>Tenor (in months)</b></td><td><b>6</b></td><td><b>12</b></td><td><b>12</b></td><td><b>12</b></td></tr><tr><td><b>Currency</b></td><td><b>HKD</b></td><td><b>HKD</b></td><td><b>HKD</b></td><td><b>CNY</b></td></tr><tr><td><b>Outstanding amount (at origination)</b></td><td><b>500</b></td><td><b>1500</b></td><td><b>500</b></td><td><b>93</b></td></tr><tr><td><b>Recognized collateral B in HKD (after haircut)</b></td><td>-</td><td>-</td><td colspan="2">200</td></tr><tr><td><b>Ineligible collateral C in HKD (acceptable financial asset and after haircut)</b></td><td>-</td><td>-</td><td colspan="2">400</td></tr><tr><td><b><u>Natural hedge allocation</u></b></td><td></td><td></td><td></td><td></td></tr><tr><td><b>HKD income allocated</b></td><td>-</td><td>1200</td><td>-</td><td>-</td></tr><tr><td><b>CNY income allocated</b></td><td>-</td><td>-</td><td>-</td><td>60</td></tr><tr><td><b>Asset A and collateral C allocated</b></td><td>300</td><td>150</td><td>450</td><td>-</td></tr><tr><td><b>Total</b></td><td>300</td><td>1350</td><td>450</td><td>60</td></tr><tr><td><b>Currency mismatch multiplier applicable (at origination)?</b></td><td>Yes</td><td>No</td><td>No</td><td>Yes</td></tr></table> |                     | <b>Loan 1</b>         | <b>Loan 2</b>         | <b>Loan 3</b> | <b>Loan 4</b> | <b>Nature</b> | <b>Unsecured</b> | <b>Wealth based</b> | <b>Collateralized</b> | <b>Collateralized</b> | <b>Tenor (in months)</b> | <b>6</b> | <b>12</b> | <b>12</b> | <b>12</b> | <b>Currency</b> | <b>HKD</b> | <b>HKD</b> | <b>HKD</b> | <b>CNY</b> | <b>Outstanding amount (at origination)</b> | <b>500</b> | <b>1500</b> | <b>500</b> | <b>93</b> | <b>Recognized collateral B in HKD (after haircut)</b> | - | - | 200 |  | <b>Ineligible collateral C in HKD (acceptable financial asset and after haircut)</b> | - | - | 400 |  | <b><u>Natural hedge allocation</u></b> |  |  |  |  | <b>HKD income allocated</b> | - | 1200 | - | - | <b>CNY income allocated</b> | - | - | - | 60 | <b>Asset A and collateral C allocated</b> | 300 | 150 | 450 | - | <b>Total</b> | 300 | 1350 | 450 | 60 | <b>Currency mismatch multiplier applicable (at origination)?</b> | Yes | No | No | Yes |
|                                                                                      | <b>Loan 1</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | <b>Loan 2</b>       | <b>Loan 3</b>         | <b>Loan 4</b>         |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>Nature</b>                                                                        | <b>Unsecured</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | <b>Wealth based</b> | <b>Collateralized</b> | <b>Collateralized</b> |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>Tenor (in months)</b>                                                             | <b>6</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | <b>12</b>           | <b>12</b>             | <b>12</b>             |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>Currency</b>                                                                      | <b>HKD</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | <b>HKD</b>          | <b>HKD</b>            | <b>CNY</b>            |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>Outstanding amount (at origination)</b>                                           | <b>500</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | <b>1500</b>         | <b>500</b>            | <b>93</b>             |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>Recognized collateral B in HKD (after haircut)</b>                                | -                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | -                   | 200                   |                       |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>Ineligible collateral C in HKD (acceptable financial asset and after haircut)</b> | -                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | -                   | 400                   |                       |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b><u>Natural hedge allocation</u></b>                                               |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |                     |                       |                       |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>HKD income allocated</b>                                                          | -                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 1200                | -                     | -                     |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>CNY income allocated</b>                                                          | -                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | -                   | -                     | 60                    |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>Asset A and collateral C allocated</b>                                            | 300                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | 150                 | 450                   | -                     |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>Total</b>                                                                         | 300                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | 1350                | 450                   | 60                    |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| <b>Currency mismatch multiplier applicable (at origination)?</b>                     | Yes                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | No                  | No                    | Yes                   |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| A76.                                                                                 | <p>Grouping approach like the one described is acceptable as long as the grouping and allocation reflect correctly the reality (including differences in loan maturities/repayment structures and the contractual or legal rights of the AI in respect of the loans and natural hedges). For example, if, under the loan/collateral agreements for Loans 3 and 4, the AI is entitled to use the proceeds from the disposal of collateral C to offset the borrower’s other amounts owed to the AI (e.g. Loans 1 and 2), the AI may allocate part of the value of collateral C to cover Loan 1 or 2.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                     |                       |                       |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |
| Q77.                                                                                 | <p><b>Does “the total of the instalment payment amounts of the exposures” mentioned in the answer to Q74 exclude instalment payment amounts that are—</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |                     |                       |                       |               |               |               |                  |                     |                       |                       |                          |          |           |           |           |                 |            |            |            |            |                                            |            |             |            |           |                                                       |   |   |     |  |                                                                                      |   |   |     |  |                                        |  |  |  |  |                             |   |      |   |   |                             |   |   |   |    |                                           |     |     |     |   |              |     |      |     |    |                                                                  |     |    |    |     |

|      |                                                                               |
|------|-------------------------------------------------------------------------------|
|      | <p>(a) financially hedged; or</p> <p>(b) naturally hedged by other means?</p> |
| A77. | Please see paragraph (b) of the answer to Q75.                                |

*(c) Reassessment of existing exposures*

|             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
|-------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Q78.</b> | <p><b>Clarification is sought on whether AIs are expected to assess the applicability of the currency mismatch multiplier on facility level instead of on obligor level.</b></p> <p><b>For example, if a customer applies for a CNY mortgage then a HKD personal loan, should the subsequent income assessment (e.g. with updated income proof) only be used for that personal loan application (i.e. there should be no retrospective impact on the CNY mortgage loan as solid income proof was provided before)?</b></p>                                |
| A78.        | In the example cited, since the new personal loan is denominated in HKD, the HKMA considers that the status of the CNY mortgage should not be affected unless the AI is aware that (e.g. from the updated income proof obtained) the borrower's CNY income has decreased to a level less than 90% of the monthly instalment amount of the CNY mortgage (i.e. the AI is now exposed to FX risk and therefore the currency mismatch multiplier should be applied to the CNY mortgage).                                                                      |
| <b>Q79.</b> | <p><b>If an existing HKD loan granted to an obligor (whose place of residence is Hong Kong) is classified as an unhedged credit exposure based on the income information (which indicates that the income is in CNY) obtained at loan origination and subsequently a new HKD loan is granted to the same obligor but there is no sufficient information on the currency of the obligor's income, could an AI regard the new HKD loan or both loans as without currency mismatch based on §51A(4)(b) (i.e. the place of residence of the obligor)?</b></p> |
| A79.        | Since income information was obtained at the origination of the existing HKD loan and the AI does not have any new information at the time of the origination of the new HKD loan that supports a change in the currency of the borrower's income, the AI should continue to regard CNY as the currency of the borrower's income for the purpose of determining whether there is currency mismatch in respect of the new HKD loan.                                                                                                                        |
| <b>Q80.</b> | <p><b>For an existing facility granted by an AI to an obligor, is it acceptable if the AI reassesses the applicability of the currency mismatch multiplier to the facility only when a credit assessment is conducted for consideration of granting a new facility to the obligor or increasing the credit limit of the existing facility, or when periodic credit review of the existing facility is performed?</b></p>                                                                                                                                  |
| A80.        | The HKMA does not expect active monitoring or updating of borrowers' income/net worth information outside the usual credit review cycle. Hence, "a change in the currency of the obligor's source of income" mentioned in A65 and "recent information" mentioned in A66(a) would usually be new information obtained                                                                                                                                                                                                                                      |



|                                                        |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |            |            |            |                                                        |         |    |                                        |     |     |                     |            |            |
|--------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------|------------|--------------------------------------------------------|---------|----|----------------------------------------|-----|-----|---------------------|------------|------------|
|                                                        | during a recent credit review or a recent application for a new loan or limit increase. The same principle applies to the determination of the amount of natural hedge.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |            |            |            |                                                        |         |    |                                        |     |     |                     |            |            |
| Q81.                                                   | As regards the answer to Q80, AIs may not necessarily require existing customers to provide new income proof for each new application (e.g. in the case of cross-selling) or for periodic credit reviews, would this situation be regarded as “does not have readily available or sufficient information” for the purposes of §51A(4)?                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |            |            |            |                                                        |         |    |                                        |     |     |                     |            |            |
| A81.                                                   | For a loan or facility granted <u>on or after</u> 1 January 2025, if an AI considers that the income proof obtained previously is still fit for the purpose of credit decision making, the AI may continue to use that income proof to determine whether the currency mismatch multiplier is applicable to the loan or facility.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |            |            |            |                                                        |         |    |                                        |     |     |                     |            |            |
| Q82.                                                   | If reassessment at obligor level cannot be achieved due to operational difficulties such as having different originating systems with no linkage or different methods of income calculation for different retail lending facilities, is the AI concerned allowed to conduct the reassessment at account level, i.e. only when there is a credit review of the loan concerned?                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |            |            |            |                                                        |         |    |                                        |     |     |                     |            |            |
| A82.                                                   | <p>The HKMA’s expectation is as follows:</p> <p>(a) If an existing non-revolving loan of a borrower is currently classified as an unhedged credit exposure, no reassessment of the classification is required during the life of the loan.</p> <p>(b) If an existing non-revolving loan of a borrower is currently not classified as unhedged credit exposure, the high level principle is that any reliable information on the borrower’s income obtained from a new facility application must trigger reassessment of the classification of the existing non-revolving loan. However, exception to this principle is acceptable if the new facility is a revolving facility of a relatively small amount (i.e. a regulatory retail exposure).</p> <p>Assessment at account level may allow the same income being counted more than once (thus overstating the amount of natural hedge available). This may defeat the purpose of the currency mismatch multiplier requirement. If an AI’s information management system is not able to support assessment and reassessment at obligor level, the AI is expected to explore solutions in overcoming the operational challenges and enhancing the AI’s ability of having a holistic view of its exposures to, and the credit quality of, a single obligor.</p> |            |            |            |                                                        |         |    |                                        |     |     |                     |            |            |
| Q83.                                                   | <p>Credit facilities have been granted to a borrower with details as set out below:</p> <table><tr><td></td><td>Facility 1</td><td>Facility 2</td></tr><tr><td>Borrower’s HKD income at loan origination (in HKD’000)</td><td>Unknown</td><td>90</td></tr><tr><td>Monthly instalment amount (in HKD’000)</td><td>100</td><td>100</td></tr><tr><td>Date of origination</td><td>1 Jan 2022</td><td>1 Mar 2025</td></tr></table>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |            | Facility 1 | Facility 2 | Borrower’s HKD income at loan origination (in HKD’000) | Unknown | 90 | Monthly instalment amount (in HKD’000) | 100 | 100 | Date of origination | 1 Jan 2022 | 1 Mar 2025 |
|                                                        | Facility 1                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Facility 2 |            |            |                                                        |         |    |                                        |     |     |                     |            |            |
| Borrower’s HKD income at loan origination (in HKD’000) | Unknown                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | 90         |            |            |                                                        |         |    |                                        |     |     |                     |            |            |
| Monthly instalment amount (in HKD’000)                 | 100                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | 100        |            |            |                                                        |         |    |                                        |     |     |                     |            |            |
| Date of origination                                    | 1 Jan 2022                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | 1 Mar 2025 |            |            |                                                        |         |    |                                        |     |     |                     |            |            |

|                                                      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |            |            |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
|------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------|------------|------------|--------------------------|--|--|--|----------------------------------------|----|----|----|---------------------|------------|------------|------------|------------------------------------------------------|--|--|--|-------------|----|---|---|-------------|----|-----|---|-------------|----|-----|----|--------------------------|--|--|--|----------------------------------------|----|----|----|---------------------|------------|------------|------------|------------------------------------------------------|--|--|--|-------------|----|---|---|-------------|----|----|---|-------------|----|-----|----|
|                                                      | Is the understanding correct that Facility 1 is not subject to the multiplier because §51A(4)(a) is applicable, and the multiplier is applicable to Facility 2 because the HKD income (after excluding 90% of the instalment amount of Facility 1) is insufficient to hedge the instalment amount of Facility 2?                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |            |            |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| A83.                                                 | When granting Facility 2, the currencies and amounts of the borrower’s income became known to the AI. Hence, the status of Facility 1 must be reassessed at the time of the origination of Facility 2 based on the new information obtained. Please also see Q65 and Q80.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |            |            |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| Q84.                                                 | <p>Clarification is sought on whether the conclusions (see the table below) regarding the applicability of the currency mismatch multiplier are correct, and whether the alternative treatment described below is acceptable.</p> <p><b>Borrower’s monthly income in HKD: 90,000</b></p> <table><tr><td></td><td>Facility A</td><td>Facility B</td><td>Facility C</td></tr><tr><td><b><u>Scenario 1</u></b></td><td></td><td></td><td></td></tr><tr><td>Monthly instalment amount (in HKD’000)</td><td>70</td><td>50</td><td>30</td></tr><tr><td>Date of origination</td><td>1 Jan 202X</td><td>1 May 202X</td><td>1 Dec 202X</td></tr><tr><td>Currency mismatch multiplier applicable on and from:</td><td></td><td></td><td></td></tr><tr><td>1 Jan 202X?</td><td>No</td><td>-</td><td>-</td></tr><tr><td>1 May 202X?</td><td>No</td><td>Yes</td><td>-</td></tr><tr><td>1 Dec 202X?</td><td>No</td><td>Yes</td><td>No</td></tr><tr><td><b><u>Scenario 2</u></b></td><td></td><td></td><td></td></tr><tr><td>Monthly instalment amount (in HKD’000)</td><td>70</td><td>10</td><td>30</td></tr><tr><td>Date of origination</td><td>1 Jan 202X</td><td>1 May 202X</td><td>1 Dec 202X</td></tr><tr><td>Currency mismatch multiplier applicable on and from:</td><td></td><td></td><td></td></tr><tr><td>1 Jan 202X?</td><td>No</td><td>-</td><td>-</td></tr><tr><td>1 May 202X?</td><td>No</td><td>No</td><td>-</td></tr><tr><td>1 Dec 202X?</td><td>No</td><td>Yes</td><td>No</td></tr></table> <p><b><u>Rationale</u></b></p> <p>(a) In Scenario 1, at the time when Facility C is granted, since the income is sufficient to hedge 90% of the instalment amounts of Facilities A and C, the AI could apply the currency mismatch multiplier to Facility B only instead of both Facilities B and C.</p> <p>(b) In Scenario 2, at the time when Facility C is granted, since the income is sufficient to hedge 90% of the instalment amounts of Facilities A and C, the AI could apply the currency mismatch multiplier to Facility B instead of Facility C.</p> |            | Facility A | Facility B | Facility C | <b><u>Scenario 1</u></b> |  |  |  | Monthly instalment amount (in HKD’000) | 70 | 50 | 30 | Date of origination | 1 Jan 202X | 1 May 202X | 1 Dec 202X | Currency mismatch multiplier applicable on and from: |  |  |  | 1 Jan 202X? | No | - | - | 1 May 202X? | No | Yes | - | 1 Dec 202X? | No | Yes | No | <b><u>Scenario 2</u></b> |  |  |  | Monthly instalment amount (in HKD’000) | 70 | 10 | 30 | Date of origination | 1 Jan 202X | 1 May 202X | 1 Dec 202X | Currency mismatch multiplier applicable on and from: |  |  |  | 1 Jan 202X? | No | - | - | 1 May 202X? | No | No | - | 1 Dec 202X? | No | Yes | No |
|                                                      | Facility A                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | Facility B | Facility C |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| <b><u>Scenario 1</u></b>                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |            |            |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| Monthly instalment amount (in HKD’000)               | 70                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 50         | 30         |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| Date of origination                                  | 1 Jan 202X                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | 1 May 202X | 1 Dec 202X |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| Currency mismatch multiplier applicable on and from: |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |            |            |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| 1 Jan 202X?                                          | No                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | -          | -          |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| 1 May 202X?                                          | No                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Yes        | -          |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| 1 Dec 202X?                                          | No                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Yes        | No         |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| <b><u>Scenario 2</u></b>                             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |            |            |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| Monthly instalment amount (in HKD’000)               | 70                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | 10         | 30         |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| Date of origination                                  | 1 Jan 202X                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | 1 May 202X | 1 Dec 202X |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| Currency mismatch multiplier applicable on and from: |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |            |            |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| 1 Jan 202X?                                          | No                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | -          | -          |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| 1 May 202X?                                          | No                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | No         | -          |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |
| 1 Dec 202X?                                          | No                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Yes        | No         |            |            |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |     |   |             |    |     |    |                          |  |  |  |                                        |    |    |    |                     |            |            |            |                                                      |  |  |  |             |    |   |   |             |    |    |   |             |    |     |    |

|      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|      | <p><b><u>Alternative treatment</u></b></p> <p><b>In both Scenarios 1 and 2, at the time when Facility C is granted, since the income is sufficient to hedge more than 90% of the instalment amounts of Facilities B and C, the AI could, at its discretion, apply the currency mismatch multiplier to Facility A only.</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| A84. | <p>It is supposed that HKD is not the currency of the obligor's source of income, otherwise none of the HKD facilities in the 2 scenarios should be classified as an unhedged credit exposure (see paragraph (c) of the definition of "unhedged credit exposure" in §51A(1)).</p> <p>In general, if the aggregate amount of hedges for a set of credit facilities is insufficient to cover 90% of the aggregate of the monthly instalment amounts of those facilities, but is sufficient to cover 90% of the aggregate of the monthly instalment amounts of some of the facilities ("covered facilities"), then the AI is not required to apply the currency mismatch multiplier to the covered facilities. Facilities other than the covered facilities must be subject to the currency mismatch multiplier. Also see Example 2 in Q89.</p> <p>Hence, the proposed treatments set out in the table and the alternative treatment are acceptable.</p> |

#### Treatment of recognized collateral

|             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|-------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Q85.</b> | <b>Does the currency mismatch multiplier apply to exposures that are secured by recognized collateral?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| A85.        | <p>If the collateral or asset pledged is recognized collateral as defined in the BCR, the simple approach and comprehensive approach under the STC approach for handling recognized collateral already presume that the collateral or asset would be sold to repay the outstanding exposure in the event of default. More specifically—</p> <p>(a) under the simple approach, the currency mismatch multiplier does not apply to the risk-weight assigned to the credit protection covered portion of the exposure (i.e. the risk-weight applicable to the recognized collateral) but applies to the risk-weight assigned to the credit protection uncovered portion (i.e. the risk-weight applicable to the borrower); and</p> <p>(b) under the comprehensive approach, if there is any net credit exposure to the borrower after taking into account the haircut value of the collateral, the net credit exposure must be assigned a risk-weight that is equal to the product of the risk-weight applicable to the borrower and the currency mismatch multiplier.</p> |

## Natural hedge

### *(a) Acceptable assets*

|             |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|-------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Q86.</b> | <b>What is the difference between “income” and “income sources” mentioned in paragraph (d)(i) of the definition of “unhedged credit exposure” in §51A(1)?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| A86.        | The wording “income sources” is intended to accommodate natural hedges in the form of financial assets held by a borrower. The term “income” refers to cash inflows such as salaries, rentals, dividends and interest incomes, while “income sources” are assets or operations that generate incomes, e.g. debt securities and employment.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
| <b>Q87.</b> | <b>What assets are acceptable as natural hedge for wealth-based or collateralized lending?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| A87.        | <p>Subject to any guidance that may be issued by the Basel Committee from time to time, a financial asset that meets all of the following requirements is acceptable (“acceptable financial asset”)—</p> <ul style="list-style-type: none"><li>(a) the asset is free of encumbrance and denominated in the same currency as the exposure concerned;</li><li>(b) its market price can be readily and objectively valued; and</li><li>(c) there is an established liquid market in which it can be liquidated readily.</li></ul> <p>In general, in a liquid market, a large volume of assets can be readily bought or sold with minimal effect on their prices. Accordingly, the HKMA expects that the assets counted as a natural hedge must be capable of being converted into cash quickly (within 20 business days) without significant discount in value/price.</p> <p>To avoid doubt, cash value under insurance policies (regardless of whether the cash value is guaranteed or not and the time needed to redeem the cash value), and asset or income that is merely declared by a customer without any proof provided to the AI, are not acceptable.</p> |
| <b>Q88.</b> | <b>Income sources are referred to in paragraph (d)(i) of the definition of “unhedged credit exposure” in §51A(1) as a means of hedging. Does this imply that tangible or intangible assets, other than the acceptable financial assets mentioned in the answer to Q87, that are able to generate incomes (e.g. real estate, and insurance policy that generates annuity income or policy dividend) can also be regarded as natural hedge in the case of wealth-based or collateralized lending?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| A88.        | The wording of paragraph (d)(i) of the definition of “unhedged credit exposure” is to provide for the flexibility to accommodate guidance to be provided by the HKMA on the acceptable types of natural hedge.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |

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|  | As mentioned in the answer to Q87, only liquid financial assets (e.g. equities, investment funds and debt securities) are acceptable, hence, the values of any intangible assets (e.g. copyright) and other assets (e.g. real estate) will not be taken into account in calculating the amount of available natural hedge. However, as natural hedge is described in CRE20.93 of the Basel Framework as the income received by the borrower from its normal operating procedures, AIs may regard regular incomes, and incomes with high certainty in terms of timing and amount, generated by those intangible and other assets (such as rental incomes and annuity payments made under annuity plans) as natural hedge. |
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*(b) Calculation of amount of natural hedge*

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| <b>Q89.</b> | <b>For acceptable financial assets that are regarded as natural hedge, how should an AI calculate the natural hedge value and determine if the 90% threshold mentioned in paragraph (d) of the definition of “unhedged credit exposure” in §51A(1) is met for wealth-based or collateralized lending?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| A89.        | <p>(a) Wealth-based/net worth-based lending</p> <p>Subject to any guidance that may be issued by the Basel Committee from time to time and in the case of a loan (“subject loan”) in currency A, the AI should determine if the 90% threshold is met in a manner as illustrated by the numerical examples below:</p> <p>In the following examples, the total market value of the unencumbered, acceptable financial assets of the borrower in currency A = \$10,000k (“relevant asset amount”).</p> <p>(i) Example 1:</p> <p>The subject loan is an instalment loan with 240 outstanding monthly instalments where each instalment is \$30k and the borrower does not have any other in-scope exposures (see paragraph (b) of the definition of “unhedged credit exposure” in §51A(1)) in currency A. In such case, the value of the natural hedge = <math>\\$10,000\text{k} / 240 = \\$41.7\text{k}</math>. Hence, the currency mismatch multiplier does not apply to the subject loan. If the subject loan is a mortgage loan and the above calculation is conducted at origination of the loan, any down payment amount in currency A to be paid by the borrower should be deducted from the relevant asset amount.</p> <p>(ii) Example 2:</p> <p>There are two subject loans: a 1-year bullet loan of \$5,000k (“loan A”) and a loan to be repaid by 4 quarterly instalments (“loan B”) where the 4 instalment amounts are \$1,000k, \$1,500k, \$2,000k and \$2,500k respectively. In such case, the relevant asset amount is divided into 5 portions and each portion is regarded as a natural hedge against an instalment or bullet payment as illustrated below—</p> |

- 1<sup>st</sup> portion (loan A):  $\$5,000k \times 0.9 = \$4,500k$
- 2<sup>nd</sup> portion (4<sup>th</sup> instalment of loan B):  $\$2,500k \times 0.9 = \$2,250k$
- 3<sup>rd</sup> portion (3<sup>rd</sup> instalment of loan B):  $\$2,000k \times 0.9 = \$1,800k$
- 4<sup>th</sup> portion (2<sup>nd</sup> instalment of loan B):  $\$1,500k \times 0.9 = \$1,350k$
- 5<sup>th</sup> portion (1<sup>st</sup> instalment of loan B):  $\$10,000k - 9,900k = \$100k$

Since not all instalments of loan B are sufficiently hedged, loan B is subject to the currency mismatch multiplier while loan A is not. Alternatively, an AI may choose to allocate the relevant asset amount to the instalments of loan B first such that loan B is not subject to the currency mismatch multiplier but loan A is.

(b) Collateralized lending

Subject to any guidance that may be issued by the Basel Committee from time to time and in the case of a collateralized loan denominated in currency A (“subject loan”), the AI is expected to have specified a maximum loan-to-value (“LTV”) ratio for each type of asset acceptable as collateral. For the purpose of determining the applicability of the currency mismatch multiplier—

- (i) the AI must not include recognized collateral as the natural hedge of the subject loan;
- (ii) if an acceptable financial asset in currency A other than recognized collateral (“subject collateral”) is the only collateral for the subject loan—
  - in cases where the subject loan is a bullet loan and the only loan secured by the subject collateral, the amount of the natural hedge is equal to the market value of the subject collateral times the applicable maximum LTV ratio (“haircut collateral value”);
  - in cases where the subject loan is an instalment loan similar to the one in Example 1 above and the only loan secured by the subject collateral, the value of the natural hedge for each instalment is calculated in the same way as Example 1, except that “relevant asset amount” should be replaced with the haircut collateral value of the subject collateral;
  - in cases where the subject collateral secures more than one loan/facility (including the subject loan) granted by the AI (whether denominated in currency A or not) and the subject collateral is the only collateral for those loans/facilities, the AI should determine if the 90% threshold is met in a manner as illustrated by Example 3 below.

|  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
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|  | <p>(iii) Example 3:</p> <p>Currency A is HKD and the haircut collateral value of the subject collateral is HKD10,000k. There are two loans: a subject loan to be repaid by 4 quarterly instalments (“loan C”) where the 4 instalment amounts are HKD500k, HKD1,000k, HKD1,500k and HKD1,500k respectively and a GBP overdraft facility whose credit limit is equivalent to HKD5,000k (“loan D”). The haircut collateral value should be reduced by the credit limit of loan D (i.e. the amount that can be used as natural hedges for loan C is only HKD5,000k). The natural hedge against each instalment of loan C is then calculated as follows—</p> <ul style="list-style-type: none"> <li>• 1<sup>st</sup> portion (4<sup>th</sup> instalment of loan C): <math>\\$1,500k \times 0.9 = \\$1,350k</math></li> <li>• 2<sup>nd</sup> portion (3<sup>rd</sup> instalment of loan C): <math>\\$1,500k \times 0.9 = \\$1,350k</math></li> <li>• 3<sup>rd</sup> portion (2<sup>nd</sup> instalment of loan C): <math>\\$1,000k \times 0.9 = \\$900k</math></li> <li>• 4<sup>th</sup> portion (1<sup>st</sup> instalment of loan C): <math>\\$500k \times 0.9 = \\$450k</math></li> </ul> <p>Since all instalments of loan C are sufficiently hedged, loan C is not subject to the currency mismatch multiplier.</p> <p>(c) In cases where the subject loan is secured by a pool of collateral that consists of the subject collateral and one or more than one other collateral in a currency other than currency A, the amount of the natural hedge should be calculated in a similar manner as described in paragraph (b)(i) and (ii) (first and second bullets) and the collaterals in currencies other than currency A should not be taken into account in the calculation. If the pool of collateral secures more than one loan/facility (including the subject loan), any loans/facilities that are denominated in currencies other than currency A can be ignored in the calculation described in paragraph (b)(ii) (third bullet).</p> |
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## 10. **Regulatory real estate exposures**

§65(1) and (2) - criteria to be met for real estate exposure to be treated as regulatory real estate exposure

(a) *Type of properties*

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| <b>Q90.</b> | <b>If an exposure is granted for the acquisition of forest or agricultural land (“non-residential real estate”) and secured by the said real estate where all criteria set out in §65(1) are met, is the exposure a regulatory commercial real estate exposure?</b>                                                                                                                                        |
| <b>A90.</b> | For the purposes of §65 to §65E, all immovable properties other than residential properties should be treated as commercial properties. Hence, a regulatory real estate exposure secured by forest or agricultural land, unless it falls within the definition of “land acquisition, development and construction exposure” in §51(1), should be classified as regulatory commercial real estate exposure. |

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| <b>Q91.</b> | <b>Could guidance be provided on the meaning of “subsidized home ownership scheme” mentioned in §65(2)(c)(ii)(A)?</b>                                                                                                                                                                                                                                                                                                                                   |
| A91.        | In general, “subsidized home ownership scheme” refers to schemes such as the Home Ownership Scheme (居者有其屋) and the Green Form Subsidized Home Ownership Scheme (綠置居) where the developers of the properties sold under such schemes include the Hong Kong Housing Authority or a domestic public sector entity (e.g. the Urban Renewal Authority) and the properties are sold at a discount in order to provide affordable housing to qualified buyers. |
| <b>Q92.</b> | <b>For the requirement of written and reasoned legal advice set out in §65(2)(c)(ii)(B), is a blanket legal advice for each jurisdiction sufficient?</b>                                                                                                                                                                                                                                                                                                |
| A92.        | A blanket legal advice is acceptable. However, if the legal powers of the sovereign or public sector entity of the jurisdiction concerned are exercisable in relation to certain type(s) of residential properties development projects only, the AI still has the responsibility to verify that the development project in question is within the scope of the legal powers of the sovereign or public sector entity.                                  |

*(b) Loan purpose*

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| <b>Q93.</b> | <b>If an exposure is granted for cashing out the equity in a property, rather than for acquisition of the property, given all criteria set out in §65(1) are met, is the exposure a regulatory real estate exposure?</b> |
| A93.        | Cashing out equity is one of the eligible loan purposes set out in §65(1)(e). Hence, an exposure that is granted for such purpose and fulfils all other criteria set out in §65(1) is a regulatory real estate exposure. |

*(c) Underwriting policies*

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| <b>Q94.</b> | <b><sup>13</sup>Would the HKMA issue any guidance on the requirements on underwriting policies set out in §65(1)(f)?</b>                                                                                                                                                                                                                                                                                                                                                                                           |
| A94.        | Apart from the guidance set out in the SPM modules on credit risk management (e.g. CR-G-1 on “General principles of credit risk management”) and the supervisory requirements issued by the HKMA from time to time (e.g. those on LTV ratios and debt servicing ratios in respect of mortgage loans), AIs should also implement underwriting policies and procedures that mirror the <u>Principles for sound residential mortgage underwriting practices</u> (April 2012) issued by the Financial Stability Board. |

<sup>13</sup> Reference: Basel Framework CRE20.73.



(d) Valuation

|      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
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| Q95. | <sup>14</sup> According to §65(1)(g), the mortgaged property should be valued in a manner consistent with the relevant guidance issued by the Monetary Authority. Is that guidance the SPM module CR-G-7 on “Collateral and Guarantees”?                                                                                                                                                                                                                                                   |
| A95. | Yes.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| Q96. | <b>Regarding the requirements on valuation of real estate per subsection 5.4 of SPM CR-G-7, clarification is sought on whether it is suggested for all real estate collaterals to be revalued on a quarterly basis, or only for the exposures that are regarded as “large or problem”?</b>                                                                                                                                                                                                 |
| A96. | The guidance in subsection 5.4 of SPM CR-G-7 on revaluation is related to risk management for the purpose of monitoring the effectiveness of credit protection. For the purposes of the BCR, the LTV ratio of an exposure must be calculated by using the value of the mortgaged property at origination. Revaluation is needed only in the scenarios mentioned in §65A(6) and (7). SPM CR-G-7 is only relevant to §65(1)(g) which is about the manner in which a valuation is arrived at. |

§65(4)(a) - dependence on cash flows generated from mortgaged property

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| Q97. | <sup>15</sup> <b>Regarding the assessment of whether an exposure is materially dependent on the cash flows generated by the property securing the exposure (“material dependence assessment”)—</b><br><br><b>(a) are AIs required to update the assessment regularly?</b><br><br><b>(b) is there any definition of “materially dependent on”?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| A97. | (a) Having considered that mortgage loans are not usually subject to regular credit review, AIs may rely on the information obtained at loan origination for the material dependence assessment unless the AI is aware of any changes in the obligors’ sources of repayment. Nevertheless, if there is a more recent assessment conducted post loan drawdown (e.g. for considering a new loan application), AIs are expected to use the latest assessment result for the purposes of the BCR.<br><br>For loans secured by properties that are subject to regular credit review, AIs are expected to update the materially dependence assessment during the credit review.<br><br>(b) The primary source of the cash flows generated by the property would generally be lease or rental payments, or the sale of the property.<br><br>Although exposures that depend materially on the cash flows generated by the properties securing the exposures are expected to be mainly exposures to corporates (including small businesses) or SPVs, other obligor types are also |

<sup>14</sup> Reference: Basel Framework CRE20.75(2).

<sup>15</sup> Reference: Basel Framework CRE20.80.

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|  | <p>possible (e.g. individuals, which are common in Hong Kong).</p> <p>In general, it would be reasonable to consider an exposure as materially dependent if more than 50% of the obligor's income used in the AI's repayment ability assessment (e.g. in calculating the debt servicing ratio ("DSR")) is from cash flows generated by the property securing the exposure. In calculating the percentage of the obligor's total income contributed by cash flows generated by the property, if the exposure is subject to the DSR requirements promulgated by the HKMA, AIs may use the cash flows generated by the property that have been included as income for the DSR calculation as the numerator. In such case, the denominator would then be the same figure as the one used in calculating the DSR.</p> |
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§65(4)(b) and (c) - exceptions to §65(4)(a)

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| <b>Q98.</b> | <b>If an obligor declares that there is more than one primary residence, is it correct that an AI may only count one property as the obligor's primary residence and should determine which property is the primary residence based on the information provided by the obligor?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| A98.        | For the purposes of §65(4)(b) and (c), each obligor that is a natural person can only have one property as the primary residence. The AI should request the obligor to declare only one property as the primary residence. If there are legacy cases where the obligor has declared more than one property as the primary residence, the AI can only choose any one of them as the primary residence.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <b>Q99.</b> | <b>When counting the total number of residential properties for the purpose of §65(4)(c)(ii)—</b> <p><b>(a) can multiple properties covered by a single title deed be counted as one property?</b></p> <p><b>(b) can residential properties with car parking space under the same title deed be counted as one residential property?</b></p> <p><b>(c) can self-use standalone car parking space be excluded?</b></p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| A99.        | <p>(a) Residential properties covered by a single title deed can be counted as one residential property provided that the number of residential properties under the single title deed does not exceed three. However, if not all the properties are the primary residence of the individual who is the borrower or the owner of the borrower, the AI cannot rely on the ground of primary residence to claim that the exposure secured by the properties is not materially dependent on cash flows generated by the mortgaged properties.</p> <p>If there are more than three properties under the single title deed, each of the properties must be counted as one property.</p> <p>(b) Only the residential properties are counted, the car parking space will not be considered as a separate property and therefore will not be counted for the purpose of determining whether the residential real estate exposure concerned</p> |

|                                                 | <p>can be regarded as not materially dependent on cash flows generated by the mortgaged property.</p> <p>(c) Self-use standalone car parking space, which is regarded as commercial property, is not counted.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |                  |                                |                                       |                  |  |  |       |       |       |       |                                                 |                   |                  |                  |                  |                  |               |                |                  |                  |          |          |               |              |          |                  |          |                  |               |              |          |          |          |                  |
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| <b>Q100.</b>                                    | <b>When counting the total number of residential properties for the purposes of §65(4)(c)(ii), should the properties pledged for exposures that fall within §65(4)(d) be counted?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |                  |                                |                                       |                  |  |  |       |       |       |       |                                                 |                   |                  |                  |                  |                  |               |                |                  |                  |          |          |               |              |          |                  |          |                  |               |              |          |          |          |                  |
| <b>A100.</b>                                    | When counting the number of properties for the purposes of §65(4)(c), only the residential property that falls within §65(4)(b)(i) or (ii) can be excluded. All other residential properties of the same obligor (including those owned by the obligor through one or more property-holding shell companies) that are provided to the AI as security must be counted, regardless of whether the exposures secured by those other residential properties fall within §65(4)(d).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                  |                                |                                       |                  |  |  |       |       |       |       |                                                 |                   |                  |                  |                  |                  |               |                |                  |                  |          |          |               |              |          |                  |          |                  |               |              |          |          |          |                  |
| <b>Q101.</b>                                    | <p><b>Multiple residential mortgage loans were granted to the same borrower on different days. The classification of the loans during the period in which the loans remained outstanding is summarized in the table below. Clarification is sought on the correct classification of the loans on Day 3 and whether the classification on other days is correct.</b></p> <table><tr><th rowspan="2"></th><th rowspan="2">Classification under §65(4)(a)</th><th colspan="4">Classification under §65(4)(b) or (c)</th></tr><tr><th>Day 1</th><th>Day 2</th><th>Day 3</th><th>Day 4</th></tr><tr><td><b>Loan A</b><br/>(secured by primary residence)</td><td><b>Non-IPRRE*</b></td><td><b>Non-IPRRE</b></td><td><b>Non-IPRRE</b></td><td><b>Non-IPRRE</b></td><td><b>Non-IPRRE</b></td></tr><tr><td><b>Loan B</b></td><td><b>IPRRE**</b></td><td><b>Non-IPRRE</b></td><td><b>Non-IPRRE</b></td><td><b>?</b></td><td><b>-</b></td></tr><tr><td><b>Loan C</b></td><td><b>IPRRE</b></td><td><b>-</b></td><td><b>Non-IPRRE</b></td><td><b>?</b></td><td><b>Non-IPRRE</b></td></tr><tr><td><b>Loan D</b></td><td><b>IPRRE</b></td><td><b>-</b></td><td><b>-</b></td><td><b>?</b></td><td><b>Non-IPRRE</b></td></tr></table> <p><b>*Non-IPRRE denotes exposure that does not depend materially on the cash flows generated by the mortgaged property.</b></p> <p><b>**IPRRE denotes exposure that is not non-IPRRE.</b></p> <p><b>Rationale:</b></p> <p><b>(a) Day 1: Two loans were outstanding. Since the total number of mortgaged properties (after excluding the primary residence) was 1, Loan B could be treated as non-IPRRE under §65(4)(c).</b></p> <p><b>(b) Day 2: Loan C was granted on Day 2. The total number of mortgaged properties (after excluding the primary residence) increased to 2, both Loan B and Loan C could be treated as non-IPRRE under §65(4)(c).</b></p> |                  | Classification under §65(4)(a) | Classification under §65(4)(b) or (c) |                  |  |  | Day 1 | Day 2 | Day 3 | Day 4 | <b>Loan A</b><br>(secured by primary residence) | <b>Non-IPRRE*</b> | <b>Non-IPRRE</b> | <b>Non-IPRRE</b> | <b>Non-IPRRE</b> | <b>Non-IPRRE</b> | <b>Loan B</b> | <b>IPRRE**</b> | <b>Non-IPRRE</b> | <b>Non-IPRRE</b> | <b>?</b> | <b>-</b> | <b>Loan C</b> | <b>IPRRE</b> | <b>-</b> | <b>Non-IPRRE</b> | <b>?</b> | <b>Non-IPRRE</b> | <b>Loan D</b> | <b>IPRRE</b> | <b>-</b> | <b>-</b> | <b>?</b> | <b>Non-IPRRE</b> |
|                                                 | Classification under §65(4)(a)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                  |                                | Classification under §65(4)(b) or (c) |                  |  |  |       |       |       |       |                                                 |                   |                  |                  |                  |                  |               |                |                  |                  |          |          |               |              |          |                  |          |                  |               |              |          |          |          |                  |
|                                                 |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | Day 1            | Day 2                          | Day 3                                 | Day 4            |  |  |       |       |       |       |                                                 |                   |                  |                  |                  |                  |               |                |                  |                  |          |          |               |              |          |                  |          |                  |               |              |          |          |          |                  |
| <b>Loan A</b><br>(secured by primary residence) | <b>Non-IPRRE*</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | <b>Non-IPRRE</b> | <b>Non-IPRRE</b>               | <b>Non-IPRRE</b>                      | <b>Non-IPRRE</b> |  |  |       |       |       |       |                                                 |                   |                  |                  |                  |                  |               |                |                  |                  |          |          |               |              |          |                  |          |                  |               |              |          |          |          |                  |
| <b>Loan B</b>                                   | <b>IPRRE**</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | <b>Non-IPRRE</b> | <b>Non-IPRRE</b>               | <b>?</b>                              | <b>-</b>         |  |  |       |       |       |       |                                                 |                   |                  |                  |                  |                  |               |                |                  |                  |          |          |               |              |          |                  |          |                  |               |              |          |          |          |                  |
| <b>Loan C</b>                                   | <b>IPRRE</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | <b>-</b>         | <b>Non-IPRRE</b>               | <b>?</b>                              | <b>Non-IPRRE</b> |  |  |       |       |       |       |                                                 |                   |                  |                  |                  |                  |               |                |                  |                  |          |          |               |              |          |                  |          |                  |               |              |          |          |          |                  |
| <b>Loan D</b>                                   | <b>IPRRE</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | <b>-</b>         | <b>-</b>                       | <b>?</b>                              | <b>Non-IPRRE</b> |  |  |       |       |       |       |                                                 |                   |                  |                  |                  |                  |               |                |                  |                  |          |          |               |              |          |                  |          |                  |               |              |          |          |          |                  |

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| A102.        | <p>The classification of the loans is as follows:</p> <table border="1"> <tr> <th></th><th>Non-IPRE exposure?</th></tr> <tr> <td><b>RML 1</b></td><td>Yes (based on §65(4)(b)(i))</td></tr> <tr> <td><b>RML 2</b></td><td>Yes (based on §65(4)(b)(i))</td></tr> <tr> <td><b>RML 3</b></td><td>Yes or No, subject to the assessment of the AI in accordance with §65(4)(a)</td></tr> <tr> <td><b>RML 4</b></td><td>Yes or No, subject to the assessment of the AI in accordance with §65(4)(a)</td></tr> </table> <p>Since the total number of properties (excluding the primary residence) pledged by Customer A is 3 (i.e. the properties securing RML 1, RML 3 and RML 4), both RML 3 and RML 4 fail to meet the condition set out in §65(4)(c)(ii). As a result, RML 3 and RML 4 are not eligible for the preferential treatment provided for under §65(4)(c).</p> |  | Non-IPRE exposure? | <b>RML 1</b> | Yes (based on §65(4)(b)(i)) | <b>RML 2</b> | Yes (based on §65(4)(b)(i)) | <b>RML 3</b> | Yes or No, subject to the assessment of the AI in accordance with §65(4)(a) | <b>RML 4</b> | Yes or No, subject to the assessment of the AI in accordance with §65(4)(a) |
|--------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|--------------------|--------------|-----------------------------|--------------|-----------------------------|--------------|-----------------------------------------------------------------------------|--------------|-----------------------------------------------------------------------------|
|              | Non-IPRE exposure?                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |  |                    |              |                             |              |                             |              |                                                                             |              |                                                                             |
| <b>RML 1</b> | Yes (based on §65(4)(b)(i))                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |  |                    |              |                             |              |                             |              |                                                                             |              |                                                                             |
| <b>RML 2</b> | Yes (based on §65(4)(b)(i))                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |  |                    |              |                             |              |                             |              |                                                                             |              |                                                                             |
| <b>RML 3</b> | Yes or No, subject to the assessment of the AI in accordance with §65(4)(a)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |  |                    |              |                             |              |                             |              |                                                                             |              |                                                                             |
| <b>RML 4</b> | Yes or No, subject to the assessment of the AI in accordance with §65(4)(a)                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |  |                    |              |                             |              |                             |              |                                                                             |              |                                                                             |

Classification of an exposure secured by both residential and commercial properties

*(a) A collateral pool containing both residential and commercial properties*

|              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|--------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Q103.</b> | <p><b>If a regulatory real estate exposure is secured by a pool of residential and commercial properties, could the exposure be classified in the following ways—</b></p> <p><b>(a) as a regulatory residential real estate (“RRE”) exposure if only the values of the residential properties are taken into account in the LTV ratio calculation; or</b></p> <p><b>(b) as a regulatory commercial real estate (“CRE”) exposure if the values of both the commercial and residential properties are taken into account in the LTV ratio calculation?</b></p>                                                                                                                                                                                                                                                 |
| A103.        | <p>As there should be separate valuations for the commercial properties and the residential properties, the AI is expected to divide the exposure into two portions (i.e. one regulatory RRE exposure and one regulatory CRE exposure) which respectively represents the proportion of the exposure covered by each type of property. The LTV ratio of the regulatory RRE exposure should be calculated based on the valuation of the residential properties, and the LTV ratio of the regulatory CRE exposure should be calculated based on the valuation of the commercial properties. To avoid doubt, the division of the exposure is only a mathematical operation, it is not meant to require execution of a separate set of loan documentation and mortgage deed for each portion of the exposure.</p> |
| <b>Q104.</b> | <p><b>If multiple regulatory real estate exposures granted to a borrower are secured by a pool of commercial and residential properties, could the exposures be classified in the following ways—</b></p> <p><b>(a) all the exposures are classified as regulatory RRE exposures if only the values of the residential properties are taken into account in the LTV ratio calculation; or</b></p>                                                                                                                                                                                                                                                                                                                                                                                                            |

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|       | <b>(b) all the exposures are classified as regulatory CRE exposures if the values of both the commercial and residential properties are taken into account in the LTV ratio calculation?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| A104. | <p>If one or more of the exposures default, the AI is entitled to demand repayments of all other exposures, take possession of all the properties in the pool (including any excess collateral, i.e. any property that is not financed by the exposures but is provided by the borrower to offer additional comfort to the AI) and exercise its power of sale in respect of those properties, the AI must treat all exposures for financing the residential properties in the pool as a single regulatory RRE exposure, and those exposures for financing the commercial properties in the pool as a single regulatory CRE exposure. In calculating the LTV ratio of the regulatory RRE exposure, only the aggregate value of the residential properties in the pool (including any excess collaterals that are residential properties) can be taken into account. Similarly, the LTV ratio of the regulatory CRE exposure must not take into account the aggregate value of any residential properties (including any excess collaterals that are residential properties) in the pool.</p> <p>As mentioned in A103, the division of the exposures is only a mathematical operation.</p> |

*(b) A property unit that can be used for both residential and commercial purposes*

|              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
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| <b>Q105.</b> | <b>If a regulatory real estate exposure is secured by a property unit that can be used for both commercial and residential purposes, can the exposure be classified as either regulatory RRE exposure or regulatory CRE exposure based on the use claimed by the borrower?</b>                                                                                                                                                                                                                                                                                                                                                                                                                 |
| A105.        | <p>If the property unit can be used legally for both commercial and residential purposes, it is reasonable for the lending AI to categorize the loan granted for financing the acquisition of such property unit based on the intended use of the property unit declared by the borrower in the loan application. For any loan that was classified as a regulatory RRE exposure at loan origination, the AI is expected to require the borrower to obtain the AI's prior consent if, after the loan is granted, the borrower wants to change the use of the property unit from residential use to commercial use. The AI should then reclassify the exposure as "regulatory CRE exposure".</p> |

*(c) A whole block of composite (residential and commercial) building*

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| <b>Q106.</b> | <b>If a single mortgage loan is granted for the acquisition of a whole block of composite building (consisting of both commercial units and residential units) in one deed, given all requirements set out in §65(1) are met, whether the loan would be regarded as a regulatory RRE exposure?</b>                                                                                                                                                                                                                          |
| A106.        | <p>If there are separate valuations for the commercial portion and the residential portion of the building, the AI is expected to divide the mortgage loan into two portions (i.e. one regulatory RRE exposure and one regulatory CRE exposure) which respectively represents the proportion of the loan covered by each of the portions of the building. The LTV ratio of the regulatory RRE exposure should be calculated based on the valuation of the residential portion of the building, and the LTV ratio of the</p> |

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|              | <p>regulatory CRE exposure should be calculated based on the valuation of the commercial portion of the building.</p> <p>As mentioned in A103, the division of the loan into two portions is only a mathematical operation.</p> <p>For existing loans or new loan applications where the surveyor has not provided separate valuations for the residential portion and the commercial portion of the building, the AI may divide the loan and the valuation into portions according to the respective floor areas of the residential portion and the commercial portion of the building.</p> <p>It should be noted that if the whole building is acquired by the borrower for the purposes of demolition and redevelopment, the loan should be classified as ADC exposure instead of regulatory real estate exposure.</p>                                                                                                                                                                                                                                                                        |
| <b>Q107.</b> | <b>Would there be a transitional period for AIs to complete loan or asset class reclassification for mortgage loans secured by a whole block of composite building, instead of requiring AIs to perform a full review for reclassification upon the implementation date?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| <b>A107.</b> | <p>For a mortgage loan secured by a whole block of composite building granted before 1 January 2025 (“cut-off date”), the HKMA will provide for a transitional period of 1 year from the cut-off date for AIs to complete the reclassification of the loan.</p> <p>The classification of the loan under the BCR as in force immediately before the cut-off date (“pre-amended BCR”) should be used for capital calculations during the transitional period. Since the composite building consists of commercial units, the mortgage loan is not a residential mortgage loan under the pre-amended BCR. As such, the whole loan must be classified as a commercial real estate exposure during the transitional period. All other requirements set out in the revised STC approach that are applicable to real estate exposures, such as LTV ratio calculation and eligibility criteria for regulatory real estate exposures and exposures that are not materially dependent on the cash flows generated by the mortgaged properties, still apply to the loan during the transitional period.</p> |

#### LTV ratio

##### *(a) Calculation for multiple exposures secured by same collateral*

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| <b>Q108.</b> | <p><b>If a mortgage loan and a working capital loan are secured by the same property with details as follows:</b></p> <p><b>(a) mortgage loan amount = \$200</b></p> <p><b>(b) working capital loan amount = \$400</b></p> <p><b>(c) property collateral value = \$1000</b></p> <p><b>what is the LTV ratio of the mortgage loan?</b></p> |
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| A108. | According to §65A(3), both the mortgage loan amount and the working capital loan amount must be included in the LTV ratio calculation. That is, the LTV ratio for determining the risk-weight applicable to the mortgage loan will be 60% (i.e. $(200+400)/1000$ ). The treatment reflects the thinking that the working capital loan will reduce the amount of sale proceeds of the property available for repaying the mortgage loan, and therefore it should be included in the LTV ratio calculation. Otherwise, the risk of the mortgage loan is underestimated. The working capital loan will be considered as “other real estate” exposure whose risk-weight does not depend on LTV ratio. |
|-------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

*(b) Property value used in calculation*

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| <b>Q109.</b> | <b>For refinancing of a real estate exposure, if the current market value (“CMV”) of the property concerned at the time of refinancing is higher than the CMV at the time when the original exposure was granted, can the CMV at the time of refinancing be used for calculating the LTV ratio?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| A109.        | <p>If the original loan is granted by another AI, the AI providing refinancing to that loan may use the valuation of the property at the time of origination of the refinancing loan (“CMV”) to calculate the LTV ratio.</p> <p>If both loans are granted by the same AI, the following general principles will apply:</p> <ul style="list-style-type: none"> <li>(a) if the amount of the refinancing loan is larger than the outstanding amount of the original loan—CMV;</li> <li>(b) if the amount of the refinancing loan is the same as or smaller than the outstanding amount of the original loan— <ul style="list-style-type: none"> <li>(i) CMV if it is lower than the market value of the property at the time of origination of the original loan (“OCMV”);</li> <li>(ii) in any other case—OCMV.</li> </ul> </li> </ul> |

**11. Other real estate exposures**

|              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
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| <b>Q110.</b> | <b>If a general purpose loan granted to a borrower is secured by a basket of collaterals that include real estates as one of the collaterals, and the proportion of real estates in the collateral pool is small (e.g. &lt;10%) or the real estate collateral is only considered as an additional comfort, should the exposure be classified as “other real estate exposure”? Could it be classified as retail/corporate exposure depending on the type of borrower?</b> |
| A110.        | As defined in §51(1), a real estate exposure is an exposure secured by immovable property. Immovable property may not be the only collateral afforded to the exposure. Hence, as long as the general purpose loan is partially or fully secured by immovable property, it should be classified as other real estate exposure (i.e. a real                                                                                                                                |



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|              | estate exposure that is neither a regulatory real estate exposure nor an ADC exposure).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| <b>Q111.</b> | <p><b>There are scenarios that a general banking facility offered to a borrower group consists of a pool of term loans, revolving loans, overdraft, etc., and is secured by a basket of collaterals that include real estates, debt or equity securities, deposits, etc. The facility limit is shared by the members in the borrower group dynamically. Borrowers are free to replace the original collaterals by other collaterals which may be in different collateral types. There is no restriction in the composition of collateral types. Thus the loans or exposures are not always secured by real estate, and the proportion of real estate in the basket of collaterals could be really small. As long as the collateral value is sufficient, the original loans are not required to be settled or refinanced.</b></p> <p><b>In this connection, are AIs really expected to classify such exposures as other real estate exposures, even the proportion of real estate in the collateral pool is really small and could be replaced anytime? Any flexibility for AIs to classify this type of facility as retail/corporate exposure given the dynamic nature of collateral? If not, are AIs expected to proactively monitor the collaterals of these products and reclassify them as retail/corporate exposure if the underlying real estate collateral is replaced with other type of collateral?</b></p> |
| <b>A111.</b> | As explained in the answer to Q110, any exposure that is fully or partially secured by one or more immovable properties should be classified as “real estate exposure” as required under the BCR. Such classification criterion also applies to a general banking facility with a dynamic pool of collaterals. Since an AI should be notified when the borrower requests changes in the composition of the collateral pool (otherwise the AI is unable to determine whether the collateral coverage is still sufficient) and such changes may involve increase or decrease of real estate collateral, the AI is expected to review the classification after the borrower’s request is accepted.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |

## 12. ADC exposures

### Classification of exposures

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| <b>Q112.</b> | <b>Does financing of revitalization projects and renovation projects (e.g. revitalization of industrial buildings, renovation of hotel buildings, etc.) fall within the exposure class of “ADC exposure”?</b>             |
| <b>A112.</b> | Exposures arising from revitalization projects or renovation projects that do not involve development and construction of residential or commercial properties can be excluded from the exposure class of “ADC exposure”. |
| <b>Q113.</b> | <b>After the construction of the property underlying an ADC exposure is complete, will the exposure be reclassified as “regulatory real estate exposure” (§65B or §65C) or “other real estate exposure” (§65D)?</b>       |

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| A113. | Whether an exposure is an ADC exposure is determined based on its loan purpose. If an ADC exposure is granted to finance or refinance the construction of a property, the exposure is still an ADC exposure after the property is fully completed and until the exposure is fully repaid.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| Q114. | <b>There are scenarios in which the obligor in respect of an ADC exposure will need refinancing after the property concerned is fully completed (e.g. the construction of a mall, which upon completion will not be sold but will be operated as an income producing property). In this situation, if the obligor seeks refinancing from the same bank, would the original ADC exposure be considered as fully repaid and therefore the refinancing facility could be classified as a real estate exposure (other than ADC exposure), given the property concerned is fully completed and the bank has conducted sufficient due diligence work for the refinancing facility as if it were a new loan with a new loan purpose? Also, are the terms and conditions of the refinancing facility required to be determined based on the nature and purpose of the refinancing facility (instead of, e.g., sticking to the terms and conditions of the original ADC loan)?</b> |
| A114. | <p>In order for the refinancing loan granted by the same bank secured by the completed property to be classified as real estate exposure (other than ADC exposure), the loan should be considered by the bank as a new loan (instead of, e.g. an extension of the maturity of the original loan) and is subject to all relevant due diligence processes that apply to new loans.</p> <p>Since the new loan is to be secured by a completed property, the credit considerations should be different from an ADC loan. Also, the economic and property market situations may have changed. AIs are expected to take into account these factors when determining the terms and conditions of the new loan.</p> <p>AIs are reminded that the loan purpose of refinancing an ADC loan is not one of the loan purposes specified in §65(1)(e) of the BCR. Accordingly, the refinancing loan should be risk-weighted in accordance with §65D of the BCR.</p>                     |

ADC exposures eligible for 100% risk-weight

|       |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
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| Q115. | <b>Residential projects in Hong Kong usually involve development and construction of both residential units and other non-residential facilities (e.g. car parking spaces, club houses, etc.) and the latter are an integral part of the project. Hence, an AI's financing of such a project will be based on the whole project. Deliberately separating the project into residential and commercial portions for valuation, loan records, etc. is not a general market practice and may lead to significant changes to the existing operational flow. As such, clarification is sought on whether the AI may treat the ADC exposure for financing the whole project as an ADC exposure in respect of residential property for the purpose of §65F(2).</b> |
| A115. | If, according to the relevant land leases, the non-residential facilities (e.g. car parking spaces and club houses) can only be used by the residents of the residential                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |

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|              | <p>units of the project and their bona fide guests and visitors, the facilities can be included as part of the residential properties concerned.</p> <p>For other non-residential facilities, such as shopping malls, under the same project that must be classified as commercial properties, the same principle mentioned in Q106 applies to the division of the ADC exposure into residential and commercial portions when separate valuations are unavailable.</p> <p>When determining whether the requirements under the HKMA’s circular of 28 February 2024<sup>16</sup> (and any revision that may be made by the HKMA subsequently to those requirements) are met, there is no need to make the apportionment mentioned in the previous paragraph. The apportionment is just for determining the amount of the exposure to be assigned 100% risk-weight.</p> <p>As mentioned in Q106, the apportionment is just a mathematical operation to facilitate capital calculations, which should be achievable without changing the general market practice and operational flow for valuation and loan documentation.</p> |
| <b>Q116.</b> | <b>If a property development project involves construction of a building that contains both residential part (majority) and commercial part (e.g. G/F to 3/F of the building is a shopping mall and 4/F and above are residential units), could AIs classify financing of this type of property development project as ADC exposures in respect of residential properties so as to be entitled to 100% risk-weight?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| <b>A116.</b> | <p>The ADC exposure may be risk-weighted at 100%—</p> <ul style="list-style-type: none"> <li>(a) only to the extent of the portion that is for financing the development and construction of the residential units; and</li> <li>(b) only if the AI is satisfied that the repayment ability of the borrower in respect of the portion referred to in paragraph (a) does not depend on the completion of the commercial part of the project.</li> </ul> <p>If it is infeasible to identify the portion for residential units and/or the AI is uncertain about whether the condition in paragraph (b) is met, the whole ADC exposure must be risk-weighted at 150%.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| <b>Q117.</b> | <b>In determining whether an ADC exposure is eligible for a risk-weight of 100%—</b> <ul style="list-style-type: none"> <li>(a) <b>which criteria set out in §65(1) are considered applicable when assessing whether §65F(2)(a) is met?</b></li> <li>(b) <b>is it correct that “residential property” referred to in § 65F(2) only includes immovable property that falls within §65(2)(c)?</b></li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <b>A117.</b> | The policy intent is that only those criteria set out in §65(1) that are related to credit underwriting and applicable to ADC exposures should be met. Accordingly, AIs                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |

<sup>16</sup> <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2024/20240228e1.pdf>

|              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
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|              | are expected to consider, as a minimum, the requirements set out in §65(1)(b), (c), (f), (g) and (h). Hence, AIs are not required to assess eligibility against §65(2)(c).                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <b>Q118.</b> | <b>For the purpose of determining whether a property developer in respect of an ADC exposure has substantial equity at risk (see §65F(2)(b)), could AIs rely on the financing caps referred to in page 3 of the circular issued by the HKMA on 28 February 2024?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| <b>A118.</b> | <p>If an AI has granted an ADC exposure in compliance with the relevant guidance on property construction finance set out in the circular issued by the HKMA on 28 February 2024 (and any revision that may be made by the HKMA subsequently to the requirements set out in that circular) and the following guidance, it is acceptable to see this as an indication of the borrower having substantial equity at risk—</p> <ul style="list-style-type: none"> <li>(a) if the property developer has weaker financial position (e.g. higher gearing ratios), the AI should consider adopting financing ratios that are lower than those set out in the above circular where appropriate; and</li> <li>(b) in determining the site value and the expected value of the completed properties, the AI should obtain valuations from at least two independent professional valuers, and use the lower valuation as the basis for calculating the financing ratios.</li> </ul> <p>For ADC exposures in respect of residential properties in jurisdictions outside Hong Kong, the treatment set out in §65F(3) applies if the conditions specified in that subsection are met, otherwise the exposures must be subject to the 150% risk-weight under §65F(1).</p> |

### 13. **Equity exposures**

#### Examples of equity exposures

|              |                                                                                                                                                                                                                                                                                                                                                                                                      |
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| <b>Q119.</b> | <b><sup>17</sup> According to §54A(2), if an instrument represents direct or indirect ownership interests (whether voting or non-voting) in the assets and income of the issuer of the instrument or another entity, an exposure to such instrument is an equity exposure. Could some examples of indirect ownership interests be provided?</b>                                                      |
| <b>A119.</b> | <p>Indirect ownership interests include holdings of derivative contracts tied to equity interests, and holdings in corporations, partnerships, limited liability companies or other types of enterprises that issue ownership interests and are engaged principally in the business of investing in equity instruments.</p> <p>Equity investments in collective investment schemes are excluded.</p> |
| <b>Q120.</b> | <b><sup>18</sup> Could an example of an obligation falling within §54A(4)(b)(iii) be provided?</b>                                                                                                                                                                                                                                                                                                   |

<sup>17</sup> Reference: Basel Framework CRE20.54 footnote 20.

<sup>18</sup> Reference: Basel Framework CRE20.55 footnote 21.

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| A120.        | For certain obligations that require or permit settlement by issuance of a variable number of the issuer's equity shares, the change in the monetary value of the obligation is equal to the change in the fair value of a fixed number of equity shares multiplied by a specified factor. These obligations meet the conditions of §54A(4)(b)(iii) if both the specified factor and the referenced number of equity shares are fixed. For example, an issuer may be required to settle an obligation by issuing shares with a value equal to three times the appreciation in the fair value of 1,000 equity shares. That obligation is considered to be the same as an obligation that requires settlement by issuance of shares equal to the appreciation in the fair value of 3,000 equity shares. |
| <b>Q121.</b> | <b><sup>19</sup>Could an example of an obligation falling within §54A(5) be provided?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| A121.        | Equities that are recorded as a loan but arise from a debt/equity swap made as part of the orderly realisation or restructuring of the debt are included in the definition of "equity exposures".                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |

#### Speculative unlisted equity exposures

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| <b>Q122.</b> | <b>According to paragraph (a) of the definition of "speculative unlisted equity exposure" in §65G(2), speculative unlisted equity exposures include unlisted equity investments that are invested for short-term resale purposes. Guidance is sought on the definition of "short-term" in this context.</b>                                                                                                                                                                                                  |
| A122.        | AIs are expected to make their own judgement as to whether their intended holding period of the unlisted equities is "short-term". Since unlisted equities are not traded in a liquid secondary market, it is less likely that a profitable resale deal could be closed within months after acquisition of the equities. As such, a holding period of 3 to 5 years could still be considered as "short-term" in the case of highly illiquid investments.                                                     |
| <b>Q123.</b> | <b><sup>20</sup>Does "speculative unlisted equity exposures" defined in §65G(2) include the following investments/exposures?</b><br><br><b>(a) investments in unlisted equities of corporate clients with which the AI has or intends to establish a long-term business relationship;</b><br><br><b>(b) debt-equity swaps for corporate restructuring purposes; and</b><br><br><b>(c) equity exposures incurred as part of the business facilitation (e.g. membership of payment systems and exchanges).</b> |
| A123.        | These investments/exposures are not regarded as "speculative unlisted equity exposures".                                                                                                                                                                                                                                                                                                                                                                                                                     |

<sup>19</sup> Reference: Basel Framework CRE20.56 footnote 22.

<sup>20</sup> Reference: Basel Framework CRE20.58 footnote 25.

#### 14. CIS exposures - real estate investment trusts

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| Q124. | <b>For the purpose of risk-weighting an AI's equity investments in REITs under the mandate-based approach, should the risk-weighting treatments of real estate exposures be applicable to the underlying assets of REITs?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| A124. | <p>If according to the mandate of the REIT concerned or the law to which the REIT is subject, the permitted real estate investments are holdings of immovable properties such as shopping malls, the underlying assets of the REIT are physical assets instead of financial assets and the applicable section is §66 (Other exposures that are not defaulted exposures) instead of §65 (What are regulatory real estate exposures). §65 is applicable only in cases where the REIT is allowed to hold mortgage loans. If the underlying assets held by the REIT are mortgage-backed securities ("MBSs") or covered bonds, the following treatments apply—</p> <ul style="list-style-type: none"> <li>(a) MBSs, other than MBSs that fall within the definition of "securitization exposures" which are subject to Part 7 instead of Part 4 of the BCR, must be risk-weighted as exposures to the issuers of the MBSs; and</li> <li>(b) covered bonds secured by mortgage loans or similar real estate exposures must be risk-weighted in accordance with §59D if the covered bonds are eligible covered bonds defined in §2(1), otherwise the covered bonds must be risk-weighted as exposures to the bond issuers.</li> </ul> |

#### 15. Defaulted exposures

##### Defaulted real estate exposures

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| Q125. | <p><b>Clarification is sought on whether §67(1)(a) applies to a real estate exposure (other than a regulatory real estate exposure or an ADC exposure)—</b></p> <ul style="list-style-type: none"> <li>(a) <b>that is defaulted;</b></li> <li>(b) <b>that is secured by residential properties or a pool of residential and commercial properties; and</b></li> <li>(c) <b>whose repayments do not materially depend on the cash flows generated by the properties securing the exposure.</b></li> </ul>                       |
| A125. | <p>In §67(1)(a), "a residential real estate exposure" includes any real estate exposure (other than ADC exposure) that is secured by one or more residential properties. The exposure does not need to be a regulatory residential real estate exposure in order to be eligible for the 100% risk-weight.</p> <p>If the exposure is secured by a pool that contains both residential properties and commercial properties, the exposure should be subject to §67(1)(b), i.e. it should be allocated a risk-weight of 150%.</p> |

Definition of “defaulted exposure” - facility level vs obligor level

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| <b>Q126.</b> | <b>If an individual has multiple real estate exposures and one of the real estate exposures is past due for more than 90 days, should the real estate exposures that are not past due be treated as defaulted exposures under the STC approach?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| A126.        | In such case, the real estate exposure that is past due for more than 90 days must be treated as a defaulted exposure (according to §67(2)(a)). For all other real estate exposures to the individual, whether they should also be treated as defaulted exposures will depend on whether the individual is assessed by the AI concerned as a defaulted borrower according to the criteria set out in §67(4) (§67(3) does not apply to real estate exposures). If the AI chooses to apply §67(4)(a) in a conservative manner by ignoring the word “material” in that section, then all other real estate exposures that are not past due will also be treated as defaulted exposures. |
| <b>Q127.</b> | <b>Clarification is sought on whether §67(3) applies to account level or product level (e.g. cards level where multiple accounts are allowed).</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| A127.        | If more than one credit card is issued by the AI to an individual, each credit card account is considered as a single retail exposure.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| <b>Q128.</b> | <b>If an AI has a credit card exposure and a real estate exposure to an individual, clarification is sought on the treatment of these exposures under the following scenarios:</b><br><br><b>(a) the credit card exposure is past due for more than 90 days but the real estate exposure is not past due;</b><br><br><b>(b) the real estate exposure is past due for more than 90 days but the credit card exposure is not past due.</b>                                                                                                                                                                                                                                             |
| A128.        | In scenario (a), the treatment of the real estate exposure will depend on whether the individual is assessed by the AI as a defaulted borrower according to the criteria set out in §67(4). If the AI chooses to apply §67(4)(a) in a conservative manner by ignoring the word “material” in that section, then the real estate exposure will also be treated as a defaulted exposure.<br><br>In scenario (b), as provided for by §67(3)(b), the AI has the discretion to decide whether to treat the credit card exposure as a defaulted exposure.                                                                                                                                  |

§67(4) - defaulted borrower

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| <b>Q129.</b> | <b>Guidance is sought on what should be regarded as “material” in relation to the requirements set out in §67(4)(a), (b) and (d).</b>                                                                                                                                                                                                                                                                                             |
| A129.        | AIs are expected to develop their own criteria in determining the materiality of a credit obligation and the materiality of credit-related economic loss for the purposes of §67(4)(a), (b) and (d). The criteria should be prudent and applied consistently within the consolidation group of an AI and should not jeopardize the AI’s internal policies and procedures for problem credit management. If an AI’s parent bank is |

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|  | <p>incorporated outside Hong Kong and subject to capital standards and/or supervisory guidance published by the parent bank's regulator that have specified levels for materiality thresholds or other criteria for determining materiality, the AI's own criteria for determining materiality should not be less prudent than those materiality thresholds and other criteria, unless otherwise justified.</p> <p>To avoid doubt, it is acceptable for an AI to ignore the word "material" in §67(4)(a), (b) and (d).</p> |
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## 16. Off-balance sheet exposures

### Types of off-balance sheet exposure

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| <b>Q130.</b> | <b>Since most of the sale and repurchase agreements are in repo-style, what transactions would fall within Item 3 (Sale and repurchase agreements (excluding those that are repo-style transactions)) of the Table in Schedule 6?</b> |
| A130.        | Sale and repurchase agreements referred to in Item 3 of the Table are intended to capture transactions the underlying assets of which are not securities (e.g. loans or physical assets).                                             |

### Definition of "commitment" in §2 of Schedule 6

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| <b>Q131.</b> | <b>What is the treatment of off-balance sheet exposures such as conditional committed facilities that require mandatory approval from an independent regulatory or government body before drawdown?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| A131.        | Facilities of such nature also fall within the definition of "commitment" and should be subject to the same treatment applicable to commitments.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| <b>Q132.</b> | <b>For the purpose of the definition of "commitment", is there any difference between "uncommitted credit facility" and "credit facility that can be unconditionally cancelled at any time"?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| A132.        | §2 of Schedule 6 defines "commitment" as any contractual arrangement that has been offered by an AI and accepted by its customer to extend credit, purchase assets or issue credit substitutes. The term "commitment" per se may lead to misunderstanding that "uncommitted" credit facilities are excluded. However, the meaning of "commitment" given by the BCR does not exclude "uncommitted" credit facilities. Hence, "uncommitted" credit facilities, which generally include, but not limited to, facilities that can be unconditionally cancelled (i.e. an AI may, at any time, with or without cause, cancel the facility or refuse to extend credit under the facility), would fall within any one of Items 10, 11 and 12 of the Table in Schedule 6. |
| <b>Q133.</b> | <b>Would HKMA clarify the meaning of "automatic cancellation" in respect of a commitment referred to in the Table in Schedule 6 (Credit Conversion Factors) and provide an example of a product with such feature?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |



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| A133.        | “Automatic cancellation” is a term used in CRE20.100 of the Basel Framework. The HKMA believes that the Basel Committee is talking about bespoke banking facilities. There may be customised terms and conditions in the loan agreement that when a pre-specified event has occurred (e.g. certain financial indicators have exceeded certain levels), any unused credit facilities/limits will be cancelled automatically. |
| <b>Q134.</b> | <b>If uncommitted credit facilities are granted to private wealth management clients (i.e. the agreements signed by the clients explicitly state that the credit facilities are granted on an uncommitted basis), would these facilities not be considered as commitment and in turn not be subject to 10% CCF?</b>                                                                                                         |
| A134.        | Please see Q132. Credit facilities granted to private wealth management clients that fall within the definition of “commitment” must be assigned a CCF of 10% or 40%, as the case requires.                                                                                                                                                                                                                                 |

Definition of “exempt commitment” in §2 of Schedule 6

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| <b>Q135.</b> | <b>Regarding the condition set out in paragraph (f) of the definition of “exempt commitment” in §2 of Schedule 6 in relation to the assessment of creditworthiness before each drawdown, would an AI be regarded as having met such condition if the AI relies on its routine credit assessment of the obligor, supplemented by a confirmation from a party independent of the function originating the commitment, that no material adverse information has been identified subsequent to the most recent credit assessment that would affect the obligor’s creditworthiness immediately prior to the drawdown?</b>                                                                                                                                                                                                                                                                                                   |
| A135.        | <p>According to the definition of “exempt commitment” in §2 of Schedule 6, the exemption is available to corporates (including small businesses as defined in §51(1)) that are closely monitored on an ongoing basis. As such, AIs should have in place systems and controls, in addition to the periodic credit reviews, to monitor the day-to-day performance of borrowers (e.g. delinquency, over limit or other early signs of credit deterioration) so as to identify promptly any material change in the creditworthiness of the borrowers subsequent to the most recent full scope credit assessment (see SPM modules CR-G-1, CR-G-2 and CR-G-3). The party primarily responsible for the monitoring should be independent of the front office.</p> <p>For the purpose of meeting the condition set out in paragraph (f) of the definition, the HKMA would allow AIs to rely on such day-to-day monitoring.</p> |
| <b>Q136.</b> | <b>For the purpose of meeting the condition set out in paragraph (f) of the definition of “exempt commitment”, whether an AI could set up some rule-based approach, e.g. no delinquency, LTV level, etc., to fulfil the assessment requirement without the need to perform additional credit approval process?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     |
| A136.        | There is no specific requirement on how the day-to-day monitoring and the assessment before each drawdown should be conducted as long as they are prudent and appropriate for their intended purposes. However, paragraph (f) of the definition of “exempt commitment” in the BCR requires that an AI’s decision on the execution of each drawdown is only made after assessing the creditworthiness of the borrower                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |

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|              | immediately prior to drawdown. As such, there should be an approval or confirmation for the drawdown which is well documented to substantiate that the drawdown is executed based on satisfactory day-to-day monitoring results (e.g. no indication of concerns about the borrower's creditworthiness at the time of the drawdown). |
| <b>Q137.</b> | <b>If an AI offers credit invitations to corporates or SMEs for granting a credit facility, which are neither included in any facility letter nor made to existing clients, is such offer an exempt commitment?</b>                                                                                                                 |
| <b>A137.</b> | An AI must determine whether the credit invitations fall within the definitions of "commitment" and "exempt commitment" in §2 of Schedule 6. This will require examination of the terms and conditions of the credit invitations and the obligations and liabilities imposed on the AI and the customers.                           |

#### Determination of applicable CCFs

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| <b>Q138.</b> | <b><sup>21</sup>Could examples be provided to illustrate how §71(1A) works?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
| <b>A138.</b> | <p>(a) If—</p> <ul style="list-style-type: none"> <li>(i) an AI granted a credit line for a borrower to open letters of credit ("L/C") and the credit line itself is a commitment that falls with Item 12 of the Table in Schedule 6 (in other words, it is neither an exempt commitment nor a commitment that falls within Item 11 of that Table); and</li> <li>(ii) only L/Cs that fall within the definition of "trade-related contingency" in §2(1) can be opened under the credit line,</li> </ul> <p>a 20% CCF will be applied (instead of a 40% CCF) to the credit line.</p> <p>(b) If an AI granted a credit line for issuing financial guarantee (i.e. a direct credit substitute as defined in §2(1)) and such credit line can be cancelled at any time unconditionally by the AI without prior notice (i.e. it falls within Item 11 of the Table in Schedule 6), a 10% CCF will be applied (instead of a 100% CCF) to the credit line.</p> |
| <b>Q139.</b> | <b>Since Part 2 of Schedule 1 mentioned in Item 13 of the Table in Schedule 6 is currently blank, what CCF should be applied to off-balance sheet exposures that fall within Item 13?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| <b>A139.</b> | <p>If an off-balance sheet exposure falls within item 13 of the Table—</p> <ul style="list-style-type: none"> <li>(a) if Part 2 of Schedule 1 is blank, the CCF applicable to the exposure is 100%;</li> <li>(b) if Part 2 of Schedule 1 is not blank and a CCF specified in that Part is applicable to the exposure, then that CCF should be applied to the exposure; and</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |

<sup>21</sup> Reference: Basel Framework CRE20.101 footnote 46.

|              |                                                                                                                                                                                                                                                                                                                                                                                                                                            |
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|              | (c) if Part 2 of Schedule 1 is not blank and none of the CCF(s) specified in that Part is applicable to the exposure, then 100% CCF should be applied to the exposure.                                                                                                                                                                                                                                                                     |
| <b>Q140.</b> | <b>If a self-liquidating trade letter of credit—</b><br><br><b>(a) has an original maturity equal to or more than one year; and</b><br><br><b>(b) is associated with the movement of goods,</b><br><br><b>should the off-balance sheet exposure arising from such letter of credit be classified as Item 12 of the Table in Schedule 6 (i.e. “Commitments that do not fall within any of Items 1, 2, 3, 4, 5, 6, 7, 8, 9, 10 and 11”)?</b> |
| <b>A140.</b> | Since the off-balance sheet exposure does not meet the definition of “trade-related contingency” in §2(1), the exposure will be classified as Item 10 “exempt commitment” if it falls within the definition of “exempt commitment” (see §2 of Schedule 6), otherwise it will be classified as Item 12 (assuming that the exposure does not fall within Item 11).                                                                           |

#### **17. Recognized credit risk mitigation**

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| <b>Q141.</b> | <b>If an AI has put in place and implemented proper policies, procedures and processes, including valuation, and validity and enforceability checks as applicable, in accordance with the requirements in the SPM module CR-G-7 in relation to residual risks (legal, operational, liquidity and market risks), may the AI conclude that the residual risks mentioned in §77(2)(g)(ii) (recognized collateral), §98(ca)(ii) (recognized guarantee) and §99(1)(f)(ii) (recognized credit derivative contracts) are mitigated?</b>                                                                                                                                                                                                                                                                                                                                                                                              |
| <b>A141.</b> | It is unlikely to mitigate all residual risks completely with 100% certainty during the whole period in which the credit risk mitigation technique concerned is in force. Hence, having proper policies, procedures and processes to identify and manage the residual risks will not remove the need of assessing whether there is any material positive correlation between the credit quality of the obligor and the residual risks. In the assessment, an AI should consider, for example, how the relative liquidity of the collateral provided by an obligor is likely to change if the obligor is in default, whether the obligor has a considerable amount of holding in the same securities that are provided to the AI as collateral and therefore if the obligor needs to liquidate its holding of the securities to cure its financial difficulties, the price of the securities is likely to be driven down, etc. |

#### **Recognized collateral**

##### ***(a) Resolution stay***

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| <b>Q142.</b> | <b>AIs subject to “Resolution Stay” rules implemented in different jurisdictions are not allowed, under those rules, to terminate a transaction immediately even the counterparty to that transaction commits an event of default. In such</b> |
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|       | <p>situation, whether an AI would be considered as failing to meet the requirement stated in—</p> <p>(a) §77(2)(b), which requires the AI to have the right to take legal possession of the collateral in a timely manner in the event of default; or</p> <p>(b) §82(4)(h), which requires the AI to be able to terminate the transaction immediately in the event of default.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| A142. | <p>The existence of a resolution stay recognition clause will not result in the condition set out in §77(2)(b) or §82(4)(h), or any other similar requirements, say paragraph (h) of the definition of “valid bilateral netting agreement” in §2(1), not being met. For this purpose, resolution stay recognition clause means any term or condition of the contract that gives rise to the collateralized exposure to the effect that the parties to the contract agree to be bound by—</p> <p>(a) a suspension of the parties’ right to terminate the contract or to exercise rights over the collateral imposed by a resolution authority under the Financial Institutions (Resolution) Ordinance (Cap. 628); or</p> <p>(b) any similar suspension imposed by a non-Hong Kong resolution authority (within the meaning of section 2(1) of that Ordinance).</p> |

*(b) Main index*

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| <b>Q143.</b> | <b>Would the HKMA provide a list of “main index” or “main indices” for the purpose of recognizing collaterals under the simple and comprehensive approaches?</b>                                                                                                                                                |
| A143.        | <p>The definition of “main index” in §2(1) is clear. “Recognized exchange” referred to in that definition is defined in §2(1). The index products traded on the recognized exchanges can be easily identified from their websites. Hence, AIs should be able to determine whether an index is a main index.</p> |

*(c) Life insurance policy*

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| <b>Q144.</b> | <b>Could a life insurance policy pledged as collateral to an AI for premium financing/policy financing be treated as recognized collateral for the purposes of the STC approach?</b>                                                                                                                                                                                                                                                                                                                                                                                |
| A144.        | <p>Life insurance policy is not a type of collateral that may be recognized under the STC approach.</p> <p>In general, insurance policies may be treated as recognized guarantees if they satisfy all the eligibility requirements set out in §98. To avoid doubt, assignment of the rights and interests of the insured/policyholder (e.g. the borrower) under a life insurance policy to the lending AI is not regarded as a guarantee for the purpose of §98 because life insurance policy is not a type of credit insurance. Please also see Q146 and Q147.</p> |

## Recognized guarantees and recognized credit derivative contracts

### *(a) Applicable risk-weight of credit protection provider*

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| <b>Q145.</b> | <b>If an AI's exposure that is risk-weighted by using the STC approach is covered by a recognized guarantee and the guarantor falls within an IRB adoption class for which an approval to use the IRB approach has been obtained by the AI, can the AI determine the risk-weight to be assigned to the protected amount of the exposure by using the IRB approach?</b> |
| A145.        | Under §100(2)(b)(i), the risk-weight of the protected amount of the exposure must be determined in accordance with Division 3 of Part 4 (i.e. the STC approach).                                                                                                                                                                                                       |

### *(b) Recognized guarantee - eligibility requirements in §98*

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| <b>Q146.</b> | <b>When assessing whether an insurance policy (e.g. mortgage insurance) meets the eligibility requirements set out in §98, is there anything that an AI should pay attention to?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| A146.        | <p>A guarantee is considered as an instrument that allows an AI to transfer the credit risk of an exposure to the guarantor (e.g. the insurance company in the case of an insurance policy). The eligibility requirements in §98 should be assessed against the terms and conditions of the guarantee contract entered into by the guarantor and the AI. In this regard—</p> <ul style="list-style-type: none"><li>(a) the word “guarantee” in §98 should be construed as “insurance policy” and “guarantor” should be construed as “insurer”;</li><li>(b) §98(c) should be interpreted as requiring the exposure concerned (e.g. a mortgage loan) to be the subject matter of the guarantee. In other words, the exposure must be specified in the guarantee contract (or the insurance policy if the AI intends to recognize such policy for capital purposes); and</li><li>(c) §98(d) is intended to ensure that the terms and conditions of the guarantee contract have provided that if the AI suffers a loss as a result of an event of default (as defined in the guarantee contract) relating to the guaranteed exposure, the guarantor is obliged to pay an amount as defined in the guarantee contract to the AI. Hence, in the case of an insurance policy, the AI should assess whether the circumstances specified in the insurance policy under which the insurance company is obliged to make payment to the AI (i.e. the risks insured or insurance coverage) include the default of the borrower relating to the guaranteed exposure.</li></ul> |
| <b>Q147.</b> | <b>Insurance companies are generally able to cancel a policy if the policy holder has any fraudulent behavior (e.g. using fake ID, misstatement of health condition), would such a mechanism be regarded as a breach of §98(e) and cause an insurance policy to fail to be a recognized guarantee?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| A147.        | For insurance policies that may be recognized under the BCR (e.g. mortgage insurance), the policy holder is the AI itself. It is under the direct control of the AI to avoid any act that would result in the insurance policy being cancelled by the                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |

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|  | insurer. Hence, the existence of a clause that allows the insurer to cancel the policy if the AI (as the policy holder) has any fraudulent behavior is not a breach of §98(e). |
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*(c) Guarantees provided by related companies*

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| <b>Q148.</b> | <b>According to §98(ca)(i), the credit quality of the obligor in respect of an exposure covered by a guarantee must not have material positive correlation with the credit quality of the guarantor concerned. Hence, it appears that guarantees provided by the obligor’s parent, subsidiaries or affiliate companies are not recognized for the purposes of the STC approach because the credit qualities of these parties are likely to be positively correlated with the credit quality of the obligor. Is this understanding correct?</b>                                                                                                                                                    |
| <b>A148.</b> | The list of eligible credit protection provider set out in §99A does not exclude parent, subsidiaries and affiliate companies of the obligor. Guarantees provided by these entities are recognized provided that all the conditions set out in §98 are met, and for this purpose, there is no presumed material positive correlation between the obligor and its parent, subsidiary or affiliate company. AIs are expected to prudently assess whether material positive correlation exists (e.g. if the guarantee is provided by the obligor’s parent, whether the obligor is the major source of income of its parent) in order to determine whether the guarantee concerned can be recognized. |

*(d) §99A - prudentially regulated financial institutions*

|              |                                                                                                                           |
|--------------|---------------------------------------------------------------------------------------------------------------------------|
| <b>Q149.</b> | <b>Could further guidance be provided on the definition of “prudentially regulated financial institution” in §99A(3)?</b> |
|--------------|---------------------------------------------------------------------------------------------------------------------------|

| A149.                                                                                                                                                                  | <p>The definition of “prudentially regulated financial institution” is formulated to take into consideration the classifications necessary for risk-weighting purposes under the STC approach.</p> <table><tr><th>Features of entities</th><th>Classification for risk-weighting purposes</th><th>Classification for credit risk mitigation purposes</th></tr><tr><td>Non-bank entities engaged in regulated financial activities subject to <u>regulatory and supervisory standards comparable to those for banks</u></td><td>QNBFI</td><td>Prudentially regulated financial institution</td></tr><tr><td>Non-bank entities engaged in regulated financial activities subject to supervisory standards consistent with international norms but not comparable to those for banks</td><td>Corporate</td><td>Prudentially regulated financial institution</td></tr><tr><td>Non-bank entities engaged in regulated financial activities subject to <u>supervisory standards that are not consistent with international norms</u></td><td>Corporate</td><td>Corporate</td></tr><tr><td>Non-bank entities engaged in financial activities that are not regulated financial activities</td><td>Corporate</td><td>Corporate</td></tr></table> | Features of entities                               | Classification for risk-weighting purposes | Classification for credit risk mitigation purposes | Non-bank entities engaged in regulated financial activities subject to <u>regulatory and supervisory standards comparable to those for banks</u> | QNBFI | Prudentially regulated financial institution | Non-bank entities engaged in regulated financial activities subject to supervisory standards consistent with international norms but not comparable to those for banks | Corporate | Prudentially regulated financial institution | Non-bank entities engaged in regulated financial activities subject to <u>supervisory standards that are not consistent with international norms</u> | Corporate | Corporate | Non-bank entities engaged in financial activities that are not regulated financial activities | Corporate | Corporate |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------|--------------------------------------------|----------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------|-------|----------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|----------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|-----------|-----------------------------------------------------------------------------------------------|-----------|-----------|
| Features of entities                                                                                                                                                   | Classification for risk-weighting purposes                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | Classification for credit risk mitigation purposes |                                            |                                                    |                                                                                                                                                  |       |                                              |                                                                                                                                                                        |           |                                              |                                                                                                                                                      |           |           |                                                                                               |           |           |
| Non-bank entities engaged in regulated financial activities subject to <u>regulatory and supervisory standards comparable to those for banks</u>                       | QNBFI                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | Prudentially regulated financial institution       |                                            |                                                    |                                                                                                                                                  |       |                                              |                                                                                                                                                                        |           |                                              |                                                                                                                                                      |           |           |                                                                                               |           |           |
| Non-bank entities engaged in regulated financial activities subject to supervisory standards consistent with international norms but not comparable to those for banks | Corporate                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | Prudentially regulated financial institution       |                                            |                                                    |                                                                                                                                                  |       |                                              |                                                                                                                                                                        |           |                                              |                                                                                                                                                      |           |           |                                                                                               |           |           |
| Non-bank entities engaged in regulated financial activities subject to <u>supervisory standards that are not consistent with international norms</u>                   | Corporate                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | Corporate                                          |                                            |                                                    |                                                                                                                                                  |       |                                              |                                                                                                                                                                        |           |                                              |                                                                                                                                                      |           |           |                                                                                               |           |           |
| Non-bank entities engaged in financial activities that are not regulated financial activities                                                                          | Corporate                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               | Corporate                                          |                                            |                                                    |                                                                                                                                                  |       |                                              |                                                                                                                                                                        |           |                                              |                                                                                                                                                      |           |           |                                                                                               |           |           |
| Q150.                                                                                                                                                                  | <b>What are the differences between the entities defined in paragraphs (a) and (b) of the definition of “prudentially regulated financial institution” in §99A(3)?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                                    |                                            |                                                    |                                                                                                                                                  |       |                                              |                                                                                                                                                                        |           |                                              |                                                                                                                                                      |           |           |                                                                                               |           |           |
| A150.                                                                                                                                                                  | Paragraph (a) of the definition refers to entities (other than banks) subject to supervisory standards comparable to those applicable to banks, while paragraph (b) of the definition refers to entities (other than banks) subject to supervisory standards that are not comparable to those applicable to banks but are substantially consistent with international norms.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |                                                    |                                            |                                                    |                                                                                                                                                  |       |                                              |                                                                                                                                                                        |           |                                              |                                                                                                                                                      |           |           |                                                                                               |           |           |
| Q151.                                                                                                                                                                  | <b>How should AIs assess whether an entity is a major entity in a group for the purposes of paragraph (c) of the definition of “prudentially regulated financial institution” in §99A(3)?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |                                                    |                                            |                                                    |                                                                                                                                                  |       |                                              |                                                                                                                                                                        |           |                                              |                                                                                                                                                      |           |           |                                                                                               |           |           |
| A151.                                                                                                                                                                  | There is no simple and single rule to determine whether an entity is a major entity. Although asset size, net profit, total income, etc. are usually the commonly used financial metrics, it may also be appropriate to take into consideration other relevant risk-based factors, such as size of risk exposures. Hence, AIs are expected to exercise expert judgement in deciding which metric(s) should be used after considering the specific circumstances of the entity and the group concerned.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |                                                    |                                            |                                                    |                                                                                                                                                  |       |                                              |                                                                                                                                                                        |           |                                              |                                                                                                                                                      |           |           |                                                                                               |           |           |

### Multiple recognized credit risk mitigation

|              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|--------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Q152.</b> | <b>If a defaulted exposure is covered by insurance protection and collateral, can the insurance covered portion be applied to the underwater portion of the collateral?</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| <b>A152.</b> | <p>The treatments for multiple recognized credit risk mitigation are set out in §102 of the BCR and apply to all banking book exposures including defaulted exposures.</p> <p>If an exposure is partially secured by recognized collateral and partially covered by a recognized guarantee in the form of insurance, §102 does not prohibit allocating the insurance protection to the portion of the exposure that is not secured by the collateral if such allocation is consistent with the rights of the AI and the insurance coverage under the security documents and the insurance policy concerned.</p> <p>If the exposure concerned is a mortgage loan in negative equity with a mortgage insurance, §102 is not applicable because only the mortgage insurance may be considered as recognized guarantee (real estate is not a type of collateral that may be recognized under the STC approach). The credit protection covered portion in relation to the mortgage insurance must be determined in accordance with the terms and conditions of the mortgage insurance policy and based on the current outstanding loan amount. If an AI has classified the mortgage loan as a defaulted exposure according to the criteria set out in §67(2) and (4), the credit protection uncovered portion of the loan (i.e. the portion not covered by the mortgage insurance) should be risk-weighted according to §67(1)(a) or (b), as the case requires.</p> |



Annex 1

(For simplicity, charges, fees and interests are ignored in the example below)

ABC 銀行      ABC Bank

信用卡戶口月結單      STATEMENT OF CREDIT CARD ACCOUNT

樣本  
SAMPLE

Customer Name  
  
Customer Address

|                       |                     |
|-----------------------|---------------------|
| 戶口號碼 Account Number   | XXXX XXXX XXXX XXXX |
| 信用限額 Credit Limit     | HKD XX,XXX          |
| 總結欠 Statement Balance | HKD 23,787.00       |
| 最低還款額 Minimum Payment | HKD 238.00          |
| 結單日 Statement Date    | XX APR 2024         |
| 到期還款日 Due Date        | XX MAY 2024         |

| 交易日期<br>Trans Date                        | 過帳日期<br>Post Date | 交易說明<br>Description of Transaction               | 金額(港幣)<br>Amount(HKD) |
|-------------------------------------------|-------------------|--------------------------------------------------|-----------------------|
| 19 Mar                                    | 19 Mar            | 上期結餘 Previous Balance                            | 7,118.00              |
| 24 Mar                                    | 25 Mar            | Merchant or Cash Advance Installment Plan #12/24 | 2,027.00              |
| 26 Mar                                    | 26 Mar            | Purchases                                        | 11,760.00             |
| 12 Apr                                    | 13 Apr            | Cash advance or Balance Transfer/Consolidation   | 10,000.00             |
|                                           |                   | Payment                                          | 7,118.00 CR           |
|                                           |                   | 今期結餘 Current Balance                             | 23,787.00             |
| ***** 財務費用概覽 Finance Charge Summary ***** |                   |                                                  |                       |
| 類別                                        |                   | 實際年利率                                            | 財務費用                  |
| Type                                      |                   | APR%                                             | Finance Charge        |
| 購物簽帳 Retail Purchase                      |                   | 34.46%                                           | HKDXXX.XX             |
| 現金透支 Cash Advance                         |                   | 35.61%                                           | HKDXXX.XX             |

|                          |   |                                 |   |                             |   |                      |   |                              |   |                         |   |                                       |   |                         |
|--------------------------|---|---------------------------------|---|-----------------------------|---|----------------------|---|------------------------------|---|-------------------------|---|---------------------------------------|---|-------------------------|
| 上期結餘<br>Previous Balance | — | 還款/<br>其他收入<br>Payment & Credit | + | 購物<br>簽帳<br>Retail Purchase | + | 現金透支<br>Cash Advance | + | 財務<br>費用<br>Financial Charge | + | 逾期<br>費用<br>Late Charge | + | 其他<br>費用/<br>調整<br>Fee/<br>Adjustment | = | 今期<br>結餘<br>New Balance |
|                          |   |                                 |   |                             |   |                      |   |                              |   |                         |   |                                       |   |                         |

\*\*\*\*\* 獎賞計劃 Rewards Programme \*\*\*\*\*

積分獎賞上期結餘 Reward Points Opening Balance

本月賺取積分獎賞 Reward Points Earned

本月行使積分獎賞 Reward Points Redeemed