HONG KONG MONETARY AUTHORITY
香港金融管理局

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20 January 2012

Ms Anita Fung
Chairman
The Hong Kong Association of Banks
Room 525, 5/F
Prince's Building
Central
Hong Kong

Dear Ms Fung,

Consultation on Basel III implementation

I am writing to consult the Association on certain aspects of the HKMA's proposals for the implementation of Basel III in Hong Kong.

For this purpose, I enclose two consultation papers relating to the Basel III capital and liquidity standards respectively. The first paper on **Implementation of Basel III Capital Standards in Hong Kong** broadly covers proposals on:

- ***definition of capital*** including the qualifying criteria, prudential filters and regulatory adjustments for determining the regulatory capital base under Basel III;

- ***risk-weighting framework for counterparty credit risk exposures*** highlighting proposed changes to the existing capital framework in respect of counterparty credit risks (CCR), including the introduction of the internal model method (IMM) and the modifications to strengthen the capital requirements for CCR as required under Basel III, as well as some enhancement to the capital treatment for certain repo-style transactions;

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- ***integration of Pillar 2*** describing the manner in which the HKMA proposes to integrate Pillar 2 capital requirements into the revised structure of minimum ratios and capital buffer requirements under Basel III; and

- ***implementation timetable*** including the HKMA's thinking on the merits of adhering to the Basel Committee's transitional timeline as against the option of early implementation.

The second paper on **Implementation of Basel III Liquidity Standards in Hong Kong** broadly covers proposals on:

- **scope of application** of the standards, discussing the categories of AI to which the various liquidity standards should apply;

- **relationship between new and existing liquidity ratios** including our analysis of whether the existing liquidity ratio in Part XVIII of, and Schedule 4 to, the Banking Ordinance should be retained or phased out, and if the ratio is to be retained, whether and how it should be modified; and

- **implementation approach and transitional timeline** referring to the proposed rule-making power in respect of liquidity requirements in the Banking (Amendment) Bill 2011 currently before LegCo and providing some illustrative timelines for the consultation and rule making exercise.

Other aspects of the Basel III reform package, including the disclosure requirements, the capital buffers, the leverage ratio and some of the more detailed aspects of the liquidity standards (such as the treatment of items subject to national discretion and definitional issues), will be the subject of future consultations. There will also be statutory consultation on the actual text of the amendments to the Banking (Capital) Rules, and Banking (Disclosure) Rules and on the proposed new Banking (Liquidity) Rules, ultimately drafted to implement the Basel III standards.

In order to comply with the Basel Committee's timetable for the implementation of Basel III, the first statutory consultation on the amendments to the Banking (Capital) Rules necessary to give effect to the three new minimum risk weighted ratios (including definition of capital and increased risk coverage in the CCR framework) is expected in the third quarter of 2012. This should enable the amended rules to be introduced into the Legislative Council for negative vetting in the fourth quarter of the year so that they may come into effect on 1 January 2013.

We would be grateful if the Association's comments on the enclosed consultation papers could reach us by 20 March 2012.

If you have any questions on the enclosed consultation papers, please feel free to contact your usual supervisory contact at the HKMA.

I am writing in similar terms to The DTC Association.

Yours sincerely,

Karen Kemp
Executive Director (Banking Policy)

Encl.

c.c. FSTB (Attn. Miss Natalie Li)