Annex 1

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Banking (Liquidity) Rules

Banking (Liquidity) Rules

Contents

Section Page

Part 1

Preliminary

1. Commencement 5
2. Interpretation 5
3. Application 9
4. Designation of category 1 institution 9

Part 2

Minimum LCR, Notifiable Matters concerning LCR and Monetization of HQLA in Certain Financial Circumstances : for Category 1 Institution

5. Minimum LCR applicable to category 1 institution 10
6. Category 1 institution must notify Monetary Authority of any matter which will or may cause it to maintain LCR less than as required under section 5 11
7. Monetization of HQLA in certain financial circumstances 11

Part 3

Minimum LMR and Notifiable Matters concerning LMR : for Category 2 Institution

8. Minimum LMR applicable to category 2 institution 11
9. Category 2 institution must notify Monetary Authority of any matter which will or may cause it to maintain LMR less than as required under section 8 11

Part 4

Valuation of Assets, etc., at Fair Value and Bases of Calculation for Purposes of LCR and LMR

10. Valuation of assets, liabilities, off-balance sheet items and cash flows measured at fair value 12
11. Calculation of LCR or LMR on Hong Kong office basis and unconsolidated basis, etc. 12
12. Calculation of LCR or LMR of authorized institution incorporated in Hong Kong on consolidated basis 13
13. Calculation of LCR or LMR of authorized institution incorporated in Hong Kong on basis other than those under sections 11 and 12 14

Part 5

Reporting Requirements

14. Authorized institution must notify Monetary Authority of certain matters concerning its associated entities 14

Section Page

15. Prescribed notification requirements for purposes of section 97I of Ordinance 14
16. Category 2 institution must notify Monetary Authority of change of business plans, etc., that may cause it to fall under Part 1 of Schedule 1 15

Part 6

Action that may be taken by Monetary Authority when notified of Certain Relevant Liquidity Event and Decisions to which Section 101B(1) of Ordinance applies

17. Conditions that Monetary Authority may impose on category 1 institution when it gives notice under section 15(1) of relevant liquidity event that falls within paragraph (a)(ii) of definition of relevant liquidity event 16
17A. Decisions to which section 101B(1) of Ordinance applies 17

Part 7

Calculation of LCR

Division 1—General

18. Interpretation – Part 7 17
19. Assets, etc., must not be double counted in calculation of LCR 18
20. Calculation of LCR on Hong Kong office basis 18
21. Calculation of LCR on unconsolidated basis 18
22. Calculation of LCR on consolidated basis 18
23. Calculation of LCR on unconsolidated or consolidated basis, etc. when there are different liquidity regulations between Hong Kong and host jurisdictions 18
24. Treatment of liquidity transfer restrictions in calculation of consolidated LCR 19
25. Treatment of liquidity transfer restrictions in calculation of unconsolidated LCR, etc. 20

Division 2—Requirements that Asset, etc., must Satisfy, etc., before it can be included in HQLA for purposes of Calculation of LCR

26. Requirements that must be satisfied before asset can be included in HQLA for purposes of calculation of LCR 20
27. Exclusion of non-qualifying asset from HQLA 21
28. Management, etc., of HQLA and any related foreign exchange risk 21
29. HQLA must have diversification of classes of assets, etc. 21
30. General exclusion of assets from HQLA, etc. 22
31. Specific exclusion of assets from HQLA, etc. 22
32. Provisions supplementary to section 26 22

Division 3—Determination of HQLA - general

Section Page

33. General requirements applicable to determination of HQLA 23
34. Calculation of total weighted amount of HQLA (without reversal of relevant securities financing transaction) 23
35. Calculation of total weighted amount of HQLA (if there is relevant securities financing transaction) 24
36. Haircuts 25

Division 4—Determination of HQLA—requirements applicable to category 1 institutions that use HQLA denominated in foreign currencies to cover portion of total net cash outflows denominated in Hong Kong dollars

37. Interpretation—Division 4 26
38. Circumstances and requirements under which category 1 institution may use HQLA denominated in foreign currencies to cover HKD LCR mismatch 27
39. Application of foreign exchange haircuts 28

Division 5—Calculation of Total Net Cash Outflows

40. Interpretation—Division 5 28
41. Calculation of total net cash outflows 33
42. Calculation of total expected cash outflows 33
43. Calculation of total expected cash inflows 37

Part 8

Calculation of LMR

Division 1—General

44. Interpretation—Part 8 38
45. Assets, etc., must not be double counted in calculation of LMR 40
46. Calculation of LMR on Hong Kong office basis 41
47. Calculation of LMR on unconsolidated basis 41
48. Calculation of LMR on consolidated basis 41

Division 2—Calculation of average LMR, liquefiable assets, qualifying liabilities, etc.

49. Calculation of average LMR in each calendar month 41
50. Requirements that must be satisfied before asset can be included in liquefiable assets for purposes of calculation of LMR 42
51. Management of liquefiable assets and related risks by category 2 institution 43
52. General exclusion of assets from liquefiable assets, etc. 43
53. Specific exclusion of assets from liquefiable assets, etc. 44

Section Page

54. Calculation of net weighted amount of qualifying liabilities (after deductions)..... 44

Schedule 1

Grounds for Designating Authorized Institution as Category 1 Institution and Exceptions to those Grounds 45

Schedule 2

Classes of Assets which may be included in HQLA for Calculating LCR and Qualifying Criteria applicable to those Classes 47

Schedule 3

Characteristic requirements that Asset must Satisfy before it can be included in HQLA for purposes of Calculation of LCR..... 54

Schedule 4

Operational requirements that Category 1 Institution and Asset must Satisfy before Asset can be included in HQLA for purposes of Calculation of LCR 55

Schedule 5

Liquidity Conversion Factors Applicable to Assets and Liabilities in Calculation of LMR ... 57

Banking (Liquidity) Rules

(Made by the Monetary Authority under section 97H of the Banking Ordinance (Cap. 155), as amended by section 8 of the Banking (Amendment) Ordinance (No. 3 of 2012) after consultation with the Financial Secretary, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, The Hong Kong Association of Banks and The Hong Kong Association of Restricted Licence Banks and Deposit-taking Companies)

Part 1

Preliminary

1. Commencement

These Rules come into operation on [1 January 2015].

2. Interpretation

(1) In these Rules—

associated entity ( ) has the meaning assigned to it by section 97H(4) of the Ordinance;

bank ( ) has the meaning assigned to it by section 2 of the Capital Rules;

Capital Rules ( ) means the Banking (Capital) Rules (Cap. 155 sub. leg. L);

category 1 institution ( ) means an authorized institution designated under section 4(1) as a category 1 institution;

category 2 institution ( ) means an authorized institution which is not a category 1 institution;

central bank ( ) means—

(a) the central bank of a country; or

(b) an authority of a country that performs in the country functions similar to the functions performed by the Monetary Authority under section 5A(2) of the Exchange Fund Ordinance (Cap. 66);

class ( ) includes a subclass;

code of practice ( ) means an approved code of practice, referred to in Part XVIC of the Ordinance, that is in force;

currency notes and coins ( ), in relation to an authorized institution, means legal tender notes or other notes, and coins, representing the lawful currency of a country or Hong Kong held by the institution;

consolidated group ( ), in relation to an authorized institution incorporated in Hong Kong that has one or more specified associated entities, means—

(a) the institution's Hong Kong office;

(b) the institution's overseas branches (if any); and

(c) the institution's specified associated entities;

convertible ( ), in relation to a currency (other than Hong Kong dollars) held by an authorized institution, means the ability of the institution to exchange funds held in that currency into Hong Kong dollars through—

(a) an active foreign exchange market; or

(b) an established exchange and clearing arrangement operated by the central bank that issues the currency (or operated by a person appointed by the central bank for that purpose);

corporate ( ) means—

(a) a company; or

(b) a partnership, or any other unincorporated body,

that is neither a public sector entity nor a financial institution;

customer ( ) includes a counterparty;

debt securities ( ) means any securities other than—

(a) equities;

(b) securities that can be converted into equities; or

(c) import or export trade bills;

determine ( ) includes calculate;

EF debt security ( ) means—

(a) an Exchange Fund Bill;

(b) an Exchange Fund Note; or

(c) any other debt security issued by the Government for the account of the Exchange Fund under the Exchange Fund Ordinance (Cap. 66);

Exchange Fund Bill ( ) means any instrument described as such as issued by the Government for the account of the Exchange Fund under the Exchange Fund Ordinance (Cap. 66);

Exchange Fund Note ( ) means any instrument described as such as issued by the Government for the account of the Exchange Fund under the Exchange Fund Ordinance (Cap. 66);

fair value ( )—

(a) in relation to an asset (whether an on-balance sheet or off-balance sheet asset), means the amount for which the asset could be exchanged between knowledgeable, willing parties in an arm's length transaction; or

(b) in relation to a liability (whether an on-balance sheet or off-balance sheet liability), means the amount for which the liability could be settled between knowledgeable, willing parties in an arm's length transaction;

financial institution ( ) has the meaning assigned to it by section 157A(3) of the Capital Rules;

guidelines ( ) means guidelines under the Ordinance that are published in the Gazette and in force;

Hong Kong office ( ), in relation to an authorized institution, means the institution's principal place of business in Hong Kong and its local branches (if any);

Hong Kong office basis ( ), in relation to an authorized institution's calculation of its LCR or LMR, means the basis referred to in section 11(1)(a);

HQLA ( ), in relation to a category 1 institution, means the institution's stock of high quality liquid assets, as determined in accordance with Part 7, that the institution is permitted to include in the calculation of its LCR;

LCR ( ) means liquidity coverage ratio;

LCR period ( ), in relation to a category 1 institution's LCR, means the period of 30 calendar days immediately following the day on which the LCR is calculated;

level 1 assets ( ) means any assets specified in section 1, Part 1 of Schedule 2;

level 2A assets ( ) means any assets specified in section 2, Part 1 of Schedule 2;

level 2B assets ( ) means any assets specified in section 3, Part 1 of Schedule 2;

liquefiable assets ( ), in relation to a category 2 institution, means the institution's stock of liquefiable assets, as determined in accordance with Part 8, that the institution is permitted to include in the calculation of its LMR;

liquidity coverage ratio ( ), in relation to a category 1 institution, means the ratio, expressed as a percentage, of the amount (calculated in Hong Kong dollars) of the institution's HQLA to the amount (calculated in Hong Kong dollars) of the institution's total net cash outflows, as calculated in accordance with Part 7;

liquidity maintenance ratio ( ), in relation to a category 2 institution, means the ratio, expressed as a percentage, of the amount (calculated in Hong Kong dollars) of the institution's liquefiable assets to the amount (calculated in Hong Kong dollars) of the institution's qualifying liabilities (after deductions), as calculated in accordance with Part 8;

liquidity transfer restriction ( ), in relation to an authorized institution, means any regulatory, legal, tax, accounting or other restriction or impediment that inhibits, or may potentially inhibit, the transfer of assets or the flow of funds between the institution's Hong Kong office, and any of its associated entities and overseas branches ;

LMR ( ) means liquidity maintenance ratio;

marketable debt securities ( ) means debt securities that have an established secondary market in or outside Hong Kong in which they can be monetized readily;

monetize ( ), in relation to an asset of an authorized institution, means converting the asset into cash by—

(a) a direct sale of the asset;

(b) entering into a repo-style transaction that is collateralized by the asset; or

(c) any other means;

pledged deposit ( ), in relation to an authorized institution, means a deposit placed with the institution by a customer (other than a bank) that is contractually pledged to the institution as collateral to secure a loan from the institution;

prescribed instrument ( ) has the meaning assigned to it by section 137B(1) of the Ordinance;

principal amount ( )—

(a) in relation to an on-balance sheet item of an authorized institution—

(i) if the item is measured at fair value, means the value of the item determined in accordance with section 10; or

(ii) if the item is not measured at fair value, means the book value (including accrued interest) of the item; or

(b) in relation to an off-balance sheet item of an authorized institution, means—

(i) subject to subparagraphs (ii) and (iii), the contracted amount;

(ii) in the case of an undrawn facility, the amount of the undrawn facility; or

(iii) in the case of a partially drawn facility, the amount of the undrawn portion;

relevant financial activity ( ), in relation to an associated entity of an authorized institution, means—

(a) an activity which is ancillary to a principal activity of the institution, including—

(i) owning and managing the institution's property; and

(ii) performing information technology functions for the institution;

(b) lending, including—

(i) the provision of consumer or mortgage credit;

(ii) factoring;

(iii) forfaiting; and

(iv) the provision of guarantees and other financial commitments;

(c) financial leasing;

(d) money transmission services;

(e) issuing and administering a means of payment, including—

(i) credit cards;

(ii) travellers' cheques; and

(iii) bank drafts;

(f) trading for the associated entity's own account, or for accounts of the entity's customers, in—

(i) money market instruments;

(ii) foreign exchange;

(iii) financial instruments which are traded on an exchange;

(iv) OTC derivative transactions; or

(v) transferable securities;

(g) participating in securities issues, including the provision of services relating to the issues;

(h) the provision of—

(i) advice to undertakings on capital structure or industrial strategy, including any matter relating to capital structure or industrial strategy; or

(ii) advice and services relating to mergers and the purchase of undertakings;

(i) money broking;

(j) portfolio management and the provision of advice in relation to portfolio management; or

(k) custodial and safekeeping services;[1]

relevant liquidity event ( ) has the meaning assigned to it by section 15(3);

residential mortgage-backed security ( ) means a debt security—

(a) that is issued by a special purpose entity or another company; and

(b) the payments in respect of which are secured by a pool of underlying residential mortgage loans originated by banks or other financial institutions;

RMBS ( ) means one or more residential mortgage-backed securities;

securities financing transaction ( ), in relation to a category 1 institution, means –

[1] "Custodial and safekeeping services" is added to the definition of "relevant financial activity" in order to reflect a similar change now being introduced in Banking (Capital) (Amendment) Rules 2014, which is under consultation.

(a) a repo-style transaction; or
(b) a margin lending transaction;

sovereign ( ) means—

(a) the Government; or

(b) the central government of a country;

specified associated entity ( ), in relation to an authorized institution incorporated in Hong Kong, means an associated entity of the institution that is the subject of a notice given to the institution under section 12(1) that is in force.

(2) A reference in these Rules to a table or formula followed by a number (including an alphanumeric number) is a reference to the table or formula, as the case may be, in these Rules bearing that number.

(3) If, under a provision of these Rules, the prior consent or approval of the Monetary Authority is required by an authorized institution in respect of any matter, the institution must seek the prior consent or approval, as the case may be, by making an application in the specified form (if any) to the Monetary Authority.

(4) If, under a provision of these Rules, the Monetary Authority is required to give, or may give, notice of any matter to all authorized institutions, or to a class of such institutions, it is sufficient compliance with that provision if the Monetary Authority publishes the notice in the Gazette.

(5) If any matter specified in a provision of these Rules is qualified by the word "adequate", "appropriate", "consistent", "material", "relevant" or "significant", then, for the purposes of assisting in ascertaining the nature of such qualification in so far as it relates to the matter, regard must be had to any guidelines or codes of practice that are applicable to the provision.

(6) If a term used in these Rules is defined in section 2(1) of the Capital Rules but not in these Rules, that section applies to the interpretation of the term as used in these Rules as it applies to the interpretation of the term as used in the Capital Rules.

(7) A reference in a provision of these Rules to a liability or asset of an authorized institution is a reference only to an on-balance sheet liability or on-balance sheet asset, as the case may be, of the institution unless the provision expressly states otherwise.

(8) A reference in a provision of these Rules to an application that may be made by an authorized institution to the Monetary Authority means an application in a specified form (if any) to the Monetary Authority.

3. Application

(1) Subject to section 97K(6) of the Ordinance, these Rules, in so far as they relate to LCR, apply to category 1 institutions only.

(2) Subject to section 97K(6) of the Ordinance, these Rules, in so far as they relate to LMR, apply to category 2 institutions only.

(3) Subsections (1) and (2) are not to be construed to prevent a provision of these Rules from applying both to category 1 institutions and category 2 institutions if the provision relates both to LCR and LMR.

4. Designation of category 1 institution

(1) The Monetary Authority may, by notice in writing to an authorized institution, designate the institution as a category 1 institution if the Monetary Authority is satisfied that, in relation to the institution—

(a) (whether on application by the institution) there are one or more grounds specified in Part 1 of Schedule 1; or

(b) (only on application by the institution) there are one or more grounds specified in Part 2 of the Schedule.

(2) A notice under subsection (1) must specify—

(a) the date from which the designation takes effect; or

(b) the occurrence of the event from which the designation takes effect.

(3) If the Monetary Authority is satisfied that an authorized institution meets the conditions specified in Part 3 of Schedule 1, the Monetary Authority may elect not to designate the institution as a category 1 institution.

(4) If an authorized institution (***the relevant institution***) has been designated as a category 1 institution, whether on application by the relevant institution, the Monetary Authority may, by notice in writing to the institution, revoke the designation on being satisfied that no such designation would be made if the relevant institution were not a category 1 institution.

(5) A notice under subsection (4) must specify—

(a) the date from which the revocation takes effect; or

(b) the occurrence of the event from which the revocation takes effect.

(6) To avoid doubt—

(a) the reference in subsection (1) to **authorized institution** includes a reference to a category 2 institution which was formerly a category 1 institution; and

(b) an authorized institution must comply with the provisions of these Rules applicable to it (including any approval granted to it under these Rules) despite any period of financial stress that it is undergoing.

Part 2

Minimum LCR, Notifiable Matters concerning LCR and Monetization of HQLA in Certain Financial Circumstances : for Category 1 Institution

5. Minimum LCR applicable to category 1 institution

(1) Subject to subsection (3), a category 1 institution must, on and after 1 January 2019, at all times maintain an LCR of not less than 100%.

(2) Subject to subsection (3), a category 1 institution must—

(a) during the year of 2015, at all times maintain an LCR of not less than 60%;

(b) during the year of 2016, at all times maintain an LCR of not less than 70%;

(c) during the year of 2017, at all times maintain an LCR of not less than 80%; and

(d) during the year of 2018, at all times maintain an LCR of not less than 90%.

(3) A category 1 institution does not contravene subsection (1) or (2) if the institution's failure to maintain an LCR of not less than the level set out in subsection (1) or (2) is due only to the institution's monetization of its HQLA as provided for in section 7.

6. Category 1 institution must notify Monetary Authority of any matter which will or may cause it to maintain LCR less than as required under section 5

(1) If a category 1 institution has reason to believe that a likely increase in its total net cash outflows or a likely reduction in its HQLA (or any combination of the increase and the reduction) will cause, or could reasonably be construed as potentially causing, whether by itself or in conjunction with any other event, the institution to maintain an LCR less than as required under section 5, the institution must—

(a) as soon as is practicable notify the Monetary Authority of the matter; and

(b) provide the Monetary Authority with any particulars of the matter that the Monetary Authority requests.

(2) To avoid doubt, subsection (1) does not apply in the case of a relevant liquidity event.

7. Monetization of HQLA in certain financial circumstances

If a category 1 institution is undergoing significant financial stress and its financial circumstances are such that, in order to meet its financial obligations as they fall due, it has no reasonable alternative other than to monetize its HQLA to the extent necessary to meet those obligations despite the fact that this might cause it to maintain an LCR less than the level set out in section 5, it may monetize its HQLA to that extent in order to meet those obligations.

Part 3

Minimum LMR and Notifiable Matters concerning LMR : for Category 2 Institution

8. Minimum LMR applicable to category 2 institution

A category 2 institution must maintain an LMR of not less than 25% on average in each calendar month.

9. Category 2 institution must notify Monetary Authority of any matter which will or may cause it to maintain LMR less than as required under section 8

(1) If a category 2 institution has reason to believe that a likely increase in its qualifying liabilities (after deductions) or a likely reduction in its liquefiable assets (or any combination of the increase and the reduction) will cause, or could reasonably be construed as potentially causing, whether by itself or in conjunction with any other event, the institution to maintain an LMR less than as required under section 8, the institution must—

(a) as soon as is practicable notify the Monetary Authority of the matter; and

(b) provide the Monetary Authority with any particulars of the matter that he requests.

(2) To avoid doubt, subsection (1) does not apply in the case of a relevant liquidity event.

Part 4

Valuation of Assets, etc., at Fair Value and Bases of Calculation for Purposes of LCR and LMR

10. Valuation of assets, liabilities, off-balance sheet items and cash flows measured at fair value

(1) If an authorized institution measures any asset, liability, off-balance sheet item or cash flow at fair value, for the purposes of calculating its LCR or LMR, the institution must establish and maintain valuation systems, controls and procedures that are effective to ensure that the valuation of any such asset, liability, off-balance sheet item or cash flow is prudent and reliable.

(2) For the purposes of subsection (1), an authorized institution must make adjustments, where appropriate, to the valuation of any asset, liability, off-balance sheet item or cash flow that is measured at fair value to account for—

(a) the limitations of the valuation model or methodology and the data used by the institution in the valuation process;

(b) the liquidity of the asset, liability, off-balance sheet item or cash flow; and

(c) other relevant factors that might reasonably be expected to affect the prudence and reliability of the valuation of the asset, liability, off-balance sheet item or cash flow.

(3) To avoid doubt, adjustments made by an authorized institution in accordance with this section may exceed adjustments made by the institution in accordance with the financial reporting standards adopted by the institution.

11. Calculation of LCR or LMR on Hong Kong office basis and unconsolidated basis, etc.

(1) An authorized institution must calculate its LCR or LMR—

(a) on the basis that the business of the institution includes all of its business in Hong Kong (being its principal place of business in Hong Kong and its local branches (if any)); and

(b) (if the institution is incorporated in Hong Kong and has an overseas branch) subject to subsection (3), on an unconsolidated basis (being the basis referred to in paragraph (a) with the inclusion of the business of the institution's overseas branches but not its associated entities).

(2) An authorized institution may apply to the Monetary Authority for approval to exclude the business of its overseas branch from the calculation of its LCR or LMR on an unconsolidated basis as referred to in subsection (1)(b).

(3) On the application under subsection (2), the Monetary Authority may, by notice in writing to the institution, determine the application by—

(a) granting approval to the institution to exclude the business of its overseas branch from the calculation of its LCR or LMR on an unconsolidated basis as referred to in subsection (1)(b) if the institution demonstrates to the satisfaction of the Monetary Authority that the liquidity risk associated with the business is immaterial; or

(b) refusing the institution's application if the Monetary Authority is not satisfied as specified in paragraph (a).

(4) A notice under subsection (3) must specify—

(a) for paragraph (a), the date, or the occurrence of an event, from which the approval takes effect; or

(b) for paragraph (b), the reasons why the Monetary Authority is not satisfied as specified in subsection (3)(a).

(5) If an authorized institution has been granted an approval under subsection (3)(a), whether on the application by the institution, the Monetary Authority may, by notice in writing to the institution , revoke the approval to the extent that the approval relates to the business of an overseas branch of the institution in respect of which the Monetary Authority is satisfied that, if the business were not the subject of the approval, he would not grant an approval under subsection (3).

(6) A notice under subsection (5) must specify the date, or the occurrence of an event, from which the revocation takes effect.

12. Calculation of LCR or LMR of authorized institution incorporated in Hong Kong on consolidated basis

(1) Subject to subsections (4) and (6) and without prejudice to the generality of section 13, the Monetary Authority may, by notice in writing to an authorized institution incorporated in Hong Kong that has one or more associated entities, require the institution to calculate its LCR or LMR on a consolidated basis (being the basis with the inclusion of all the business of the institution and one or more of its associated entities as specified in the notice).

(2) A notice under subsection (1) must specify the date, or the occurrence of an event, from which the requirement takes effect.

(3) An authorized institution must comply with the requirements of a notice given to it under subsection (1).

(4) Without prejudice to the generality of subsection (1), the Monetary Authority may, for the purpose of deciding which associated entities of an authorized institution incorporated in Hong Kong to specify in a notice under subsection (1), have regard to—

(a) the respective liquidity risks that the entities pose to the institution; and

(b) whether the respective activities of the entities fall within one or more relevant financial activities.

(5) An authorized institution may apply to the Monetary Authority for approval to exclude the business of a specified associated entity of the institution from the calculation of its LCR or LMR on a consolidated basis as referred to in subsection (1).

(6) On the application under subsection (5), the Monetary Authority may, by notice in writing to the institution, determine the application by—

(a) granting approval to the institution to exclude the business of a specified associated entity of the institution from the calculation of its LCR or LMR on a consolidated basis as referred to in subsection (1) if the institution demonstrates to the satisfaction of the Monetary Authority that the liquidity risk associated with the business is immaterial; or

(b) refusing the institution's application if the Monetary Authority is not satisfied as specified in paragraph (a).

(7) A notice under subsection (6) must specify—

(a) for paragraph (a), the date, or the occurrence of an event, from which the approval takes effect; or

(b) for paragraph (b), the reasons why the Monetary Authority is not satisfied as specified in subsection (6)(a).

(8) If an authorized institution has been granted an approval under subsection (6)(a), whether on the application by the institution, the Monetary Authority may, by notice in writing to the institution, revoke the approval to the extent that the approval relates to the business of a specified associated entity of the institution in respect of which the Monetary Authority is satisfied that, if the business were not the subject of the approval, he would not grant an approval under subsection (6)(a).

(9) A notice under subsection (8) must specify the date, or the occurrence of an event, from which the approval takes effect.

13. Calculation of LCR or LMR of authorized institution incorporated in Hong Kong on basis other than those under sections 11 and 12

(1) Where an authorized institution is incorporated in Hong Kong, if the Monetary Authority, after taking into account the liquidity risk associated with a part of the institution's business in or outside Hong Kong, is satisfied that it is prudent and reasonable to do so, the Monetary Authority may, by notice in writing to the institution, require it to calculate its LCR or LMR on the basis of that part by itself, or in conjunction with any other part of the institution's other business as specified in the notice.

(2) A notice under subsection (1) must specify the date, or the occurrence of an event, from which the requirement takes effect.

(3) An authorized institution must comply with the requirements of a notice given to it under subsection (1).

Part 5

Reporting Requirements

14. Authorized institution must notify Monetary Authority of certain matters concerning its associated entities

(1) An authorized institution that calculates its LCR or LMR on a consolidated basis as referred to in section 12(1) must give notice in writing to the Monetary Authority of any of the matters specified in subsection (2) as soon as is practicable after the institution is, or ought to be, aware of the matter.

(2) The matters referred to in subsection (1) are :

(a) an associated entity of the institution having ceased to be its associated entity;

(b) an entity having become an associated entity of the institution;

(c) the principal activities of an entity specified in paragraph (b); and

(d) any significant change to the principal activities of the institution or any of its associated entities (including an entity specified in paragraph (b)).

15. Prescribed notification requirements for purposes of section 97I of Ordinance

(1) For the purposes of section 97I of the Ordinance an authorized institution must immediately notify the Monetary Authority of a relevant liquidity event and provide the Monetary Authority with any particulars of the event that the Monetary Authority requests.

(2) If an authorized institution notifies the Monetary Authority under subsection (1) of a relevant liquidity event that falls within paragraph (a)(i), (ii) or (iv), or paragraph (b), of

the definition of ***relevant liquidity event*** in subsection (3), the institution must, at the same time as it gives the notification, also give the Monetary Authority an assessment of its liquidity position, including—

(a) the factors contributing to it having to give the Monetary Authority the notification;

(b) the measures it has taken or will take to deal with the event; and

(c) the potential duration of the event based on the institution's reasonable expectations.

(3) In this section—

relevant liquidity event ( )—

(a) in the case of a category 1 institution, means—

(i) if the institution is not the subject of a notice under section 17(1) or (2) that is in force, a failure by the institution to comply with section 5 that does not arise from it taking action under section 7 to monetize its HQLA to meet its financial obligations as they fall due;

(ii) if the institution is not the subject of a notice under section 17(1) or (2) that is in force and is taking, or is about to take, action under section 7 to monetize its HQLA to meet its financial obligations as they fall due such that the action will cause, or could reasonably be construed as potentially causing, the institution to maintain its LCR at less than the level set out in section 5;

(iii) if the institution is the subject of a notice under section 17(1) or (2) that is in force, a failure by the institution to satisfy one or more of the conditions specified in the notice; or

(iv) if the institution is a section 38 institution within the meaning of section 37, a failure by the institution to comply with section 38(d); or

(b) in the case of a category 2 institution, means a failure by the institution to comply with section 8.

16. Category 2 institution must notify Monetary Authority of change of business plans, etc., that may cause it to fall under Part 1 of Schedule 1

(1) Subject to subsection (2), if a category 2 institution's business plans, or particular circumstances, change, or are expected to change, in a manner that may be likely to cause one or more grounds specified in Part 1 of Schedule 1 to arise in relation to the institution, the institution must—

(a) as soon as is practicable notify the Monetary Authority of the matter; and

(b) provide the Monetary Authority with any particulars of the matter that the Monetary Authority requests.

(2) A category 2 institution must comply with subsection (1) irrespective of whether Part 3 of Schedule 1 may apply to it.

Part 6

Action that may be taken by Monetary Authority when notified of Certain Relevant Liquidity Event and Decisions to which Section 101B(1) of Ordinance applies

17. Conditions that Monetary Authority may impose on category 1 institution when it gives notice under section 15(1) of relevant liquidity event that falls within paragraph (a)(ii) of definition of relevant liquidity event

(1) Where a category 1 institution notifies the Monetary Authority under section 15(1) of a relevant liquidity event that falls within paragraph (a)(ii) of the definition of ***relevant liquidity event*** in section 15(3), the Monetary Authority may, by notice in writing to the institution (***subsection (1) notice***), require the institution to comply with the conditions specified in the subsection (1) notice that relate to the institution's LCR and with which the Monetary Authority is satisfied that, in the circumstances of the case, it is prudent and reasonable that the institution must comply.

(2) Where a category 1 institution is the subject of a subsection (1) notice, the Monetary Authority may, at any time, by notice in writing to the institution (***subsection (2) notice***) do one or more of the following as the Monetary Authority thinks proper—

(a) amend any conditions specified in the subsection (1) notice (including amending by specifying new conditions in the subsection (1) notice); or

(b) cancel any conditions specified in the subsection (1) notice (including conditions specified in the subsection (1) notice pursuant to a prior subsection (2) notice).

(3) A notice under subsection (2) must specify the date, or the occurrence of an event, from which the amendment or the cancellation takes effect.

(4) Without prejudice to the generality of subsection (1) or (2), conditions specified in a subsection (1) or (2) notice given to a category 1 institution may include any one or more of the following—

(a) a condition that the institution must at all times maintain an LCR of not less than the percentage specified in the notice (which percentage is not more than the percentage set out in section 5);

(b) a condition that the institution must submit to the Monetary Authority a plan, within such period (being a period which is reasonable in all the circumstances of the case) as specified in the notice, satisfying the Monetary Authority that, if the plan is implemented by the institution, it would maintain, within a period which is reasonable in all the circumstances of the case, an LCR not less than the level set out in section 5;

(c) a condition that the institution must implement the plan referred to in paragraph (b) with effect from the date, or the occurrence of an event, specified in the notice;

(d) a condition requiring the institution to reduce its liquidity risk exposures in such manner, or adopt such measures, as are specified in the notice which, in the opinion of the Monetary Authority, will cause the institution to maintain, within a period reasonable in all the circumstances of the case, an LCR not less than the level set out in section 5; or

(e) a condition that the institution must make such reports regarding its LCR to the Monetary Authority as are specified in the notice

(5) A category 1 institution must comply with the requirements of a notice given to it under this section.

17A. Decisions to which section 101B(1) of Ordinance applies

A decision made by the Monetary Authority under section 4(1) or (4) or 17(1) or (2)(a) is a decision to which section 101B(1) of the Ordinance applies.

Part 7

Calculation of LCR

Division 1—General

18. Interpretation – Part 7

In this Part and Schedules 2 to 4—

approved RMBS ( ) means RMBS that falls within section 3(b) of Part 1 of Schedule 2;

central bank reserves ( ), in relation to a category 1 institution, means any funds placed by the institution with the Monetary Authority for the account of the Exchange Fund that are repayable on demand and any of the following funds placed by the institution with a central bank—

(a) funds required to be so placed by virtue of the central bank's reserve requirements but only to the extent that those funds are allowed by the central bank to be drawn down by the institution in times of financial stress;

(b) funds that are repayable on demand;

(c) term funds that are explicitly and contractually repayable on notice (which expires on the first day of the LCR period) from the institution; and

(d) term funds against which the institution can borrow from the central bank a loan on a term basis, or on an overnight but automatically renewable basis, as long as the term funds concerned are still placed with the central bank but, if the amount of the loan that the institution may borrow from the central bank against the term funds concerned and the amount of the funds are different, only the lower of those 2 amounts;

covered bond ( ) means a bond, issued by a financial institution or any of its associated entities—

(a) which is subject to relevant laws or regulations that are specially designed to protect the holder of the bond; and

(b) the proceeds from the issue of which must, in conformity with those relevant laws or regulations be invested in assets which, during the whole period of the validity of the bond, are capable of covering claims attached to the bond and which, in the event of the failure of the issuer of the bond, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest;

general wrong-way risk ( ) is to be construed in accordance with section 226E(3)(b) of the Capital Rules;

host jurisdiction ( ), in relation to a category 1 institution incorporated in Hong Kong, means a jurisdiction outside Hong Kong in which any of the institution's overseas branches operates or any of its associated entities is incorporated;

HQLA qualifying asset ( ) means an asset referred to in section 26(a);

relevant securities financing transaction ( ) means a securities financing transaction that falls with section 35(1)(a);

retail deposit ( ) has the meaning assigned to it by section 40;

small business funding ( ) has the meaning assigned to it by section 40.

19. Assets, etc., must not be double counted in calculation of LCR

(1) A category 1 institution must not, in the calculation of its LCR, double count any asset, liability, off-balance sheet item, or associated cash flow, that is included in that calculation.

(2) Without prejudice to the generality of subsection (1), a category 1 institution must not, in the calculation of its LCR, include, in its total net cash outflows, any cash inflow associated with an asset included in its HQLA for the purposes of that calculation.

20. Calculation of LCR on Hong Kong office basis

A category 1 institution must, in the calculation of its LCR on a Hong Kong office basis, determine—

(a) its HQLA held in its Hong Kong office; and

(b) the total net cash outflows of its Hong Kong office,

as if its Hong Kong office were a single legal entity.

21. Calculation of LCR on unconsolidated basis

Subject to sections 23 and 25, a category 1 institution incorporated in Hong Kong must, in the calculation of its LCR on an unconsolidated basis—

(a) determine the aggregate of its HQLA held in its Hong Kong office and its overseas branches;

(b) determine the aggregate of the total net cash outflows of its Hong Kong office and its overseas branches; and

(c) ensure that all inter-branch balances with, and transactions between, its Hong Kong office and its overseas branches are offset in that calculation.

22. Calculation of LCR on consolidated basis

(1) Subject to sections 23 and 24, a category 1 institution incorporated in Hong Kong must, in the calculation of its LCR on a consolidated basis—

(a) determine the aggregate of its HQLA held by the members of its consolidated group;

(b) determine the aggregate of the total net cash outflows of the members of its consolidated group; and

(c) ensure that all inter-branch or inter-company balances with, and transactions between, the members of its consolidated group are offset in that calculation.

(2) A category 1 institution must comply with subsection (1) as if the members of its consolidated group were a single legal entity.

23. Calculation of LCR on unconsolidated or consolidated basis, etc. when there are different liquidity regulations between Hong Kong and host jurisdictions

(1) Subject to subsections (2) to (6), a category 1 institution incorporated in Hong Kong that calculates its LCR on an unconsolidated basis, consolidated basis or on the basis specified in a notice to the institution under section 13 (if applicable), must, in so far as that calculation relates to the retail deposits and small business funding of the

institution's overseas branch (if any) or its specified associated entity (if any) incorporated outside Hong Kong, apply the liquidity regulations equivalent to LCR adopted by the relevant banking supervisory authority in the host jurisdiction concerned that are applicable to those types of deposits and that type of funding instead of the requirements of these Rules applicable to those deposits and that funding.

(2) If the relevant banking supervisory authority in the host jurisdiction of a category 1 institution's overseas branch (if any) or specified associated entity incorporated outside Hong Kong (if any) has no equivalent to LCR, the institution must apply, in the calculation of its LCR in so far as the calculation relates to the retail deposits and small business funding of that overseas branch or associated entity, as the case may be, the requirements of these Rules applicable to those deposits and that funding.

(3) Subsection (5) applies if the relevant banking supervisory authority in the host jurisdiction of a category 1 institution's overseas branch (if any) or specified associated entity incorporated outside Hong Kong (if any) has an equivalent to LCR but, for the purposes of the calculation of that equivalent to LCR in so far as it relates to retail deposits and small business funding, it has not adopted and applied any liquidity regulations .

(4) Subsection (5) applies if the Monetary Authority—

(a) is satisfied that the relevant banking supervisory authority in the host jurisdiction of a category 1 institution's overseas branch (if any) or specified associated entity incorporated outside Hong Kong (if any) has an equivalent to LCR but, for the purposes of the calculation of that equivalent to LCR in so far as it relates to retail deposits and small business funding, it has adopted and applied liquidity regulations that are less stringent than the requirements of these Rules in the calculation of a category 1 institution's LCR in so far as the calculation relates to retail deposits and small business funding; and

(b) gives that category 1 institution a notice in writing stating, in respect of the institution's overseas branches and specified associated entities incorporated outside Hong Kong specified in the notice, that it is satisfied as referred to in paragraph (a).

(5) If this subsection applies to a category 1 institution's overseas branch or specified associated entity by virtue of subsection (3) or (4), the institution must apply, in the calculation of its LCR in so far as the calculation relates to the retail deposits and small business funding of that overseas branch or associated entity, as the case may be, the requirements of these Rules applicable to those deposits and that funding.

(6) Subsection (1) does not apply to a category 1 institution's overseas branch or specified associated entity incorporated outside Hong Kong unless the relevant banking supervisory authority in the host jurisdiction concerned has issued regulations for the purposes of implementing the LCR and has prescribed liquidity regulations applicable to retail deposits and small business funding that reflect the standards issued by the Basel Committee for such deposits and funding.

(7) If subsection (1), (2) or (5) applies to a category 1 institution, the institution must construe, with all necessary modifications, the other requirements of these Rules in a manner consistent with the application of that subsection to it.

24. Treatment of liquidity transfer restrictions in calculation of consolidated LCR

(1) A category 1 institution incorporated in Hong Kong that has one or more specified associated entities must not, in the calculation of its LCR on a consolidated basis—

(a) include the HQLA held by a member of its consolidated group except to the extent that the total net cash outflows of that member is also included in the calculation; and

(b) include surplus HQLA unless—

(A) the surplus HQLA is at all times freely transferable from the member of the institution's consolidated group that holds the surplus HQLA to any other member of the group; and

(B) without prejudice to the generality of the foregoing but subject to subsection (2),—

(i) the transfer of the surplus HQLA from the jurisdiction in which it is held by the member concerned of the institution's consolidated group to any other member of the group is not subject to any liquidity transfer restriction; and

(ii) there is no reasonable doubt as to whether the surplus HQLA will at all times be freely transferable from the jurisdiction in which it is held by the member concerned of the institution's consolidated group to any other member of the group.

(2) For the purposes of subsection (1)(b)(B), when assessing the transferability of assets, a category 1 institution—

(a) is only required to take into account applicable laws, regulations and supervisory requirements of the jurisdiction in which the surplus HQLA concerned is held; and

(b) must at all times have in place and maintain adequate processes to identify and monitor the applicable laws, regulations and supervisory requirements referred to in paragraph (a).

(3) In this section—

surplus HQLA ( ), in relation to a member of a category 1 institution's consolidated group, means any of the institution's HQLA held by the member that is more than it is required to hold by prevailing regulations applicable to it.

25. Treatment of liquidity transfer restrictions in calculation of unconsolidated LCR, etc.

Section 24 applies, with all necessary modifications—

(a) to a category 1 institution incorporated in Hong Kong that calculates its LCR on an unconsolidated basis as that section applies to a category 1 institution incorporated in Hong Kong that calculates its LCR on a consolidated basis; and

(b) to a category 1 institution incorporated in Hong Kong that calculates its LCR on the basis specified in a notice given to it under section 13 as section 24 applies to a category 1 institution incorporated in Hong Kong that calculates its LCR on a consolidated basis.

Division 2—Requirements that Asset, etc., must Satisfy, etc., before it can be included in HQLA for purposes of Calculation of LCR

26. Requirements that must be satisfied before asset can be included in HQLA for purposes of calculation of LCR

A category 1 institution must not, in the calculation of its LCR, include an asset in its HQLA unless—

(a) subject to sections 30 and 31, the asset falls within a class of assets specified in Schedule 2 and meets the qualifying criteria (if any) specified in that Schedule for an asset that falls within that class;

(b) the asset satisfies all the characteristic requirements specified in Schedule 3 that are applicable to the asset;

(c) the asset satisfies all the operational requirements specified in Schedule 4 that are applicable to the asset; and

(d) the institution satisfies all the operational requirements specified in Schedule 4 that are applicable to the institution in so far as those operational requirements relate to the asset.

27. Exclusion of non-qualifying asset from HQLA

If an asset included in a category 1 institution's HQLA ceases to satisfy one or more requirements of these Rules applicable to the inclusion of an asset in HQLA (including any case where the institution fails to satisfy one or more operational requirements specified in Schedule 4 that is applicable to the institution in so far as the operational requirement concerned relates to the asset), the institution must—

(a) subject to paragraph (b), exclude the asset from its HQLA not later than 30 calendar days after the date of the cesser; or

(b) exclude the asset from its HQLA immediately if it only becomes aware of the cesser after the 30 calendar days.

28. Management, etc., of HQLA and any related foreign exchange risk

(1) A category 1 institution must have in place and maintain adequate systems and procedures for the on-going assessment and management of its HQLA in order to ensure that—

(a) each asset included in the HQLA satisfies all the requirements of these Rules that are applicable to its inclusion in the HQLA;

(b) an asset included in the HQLA which ceases to satisfy one or more requirements of these Rules applicable to its inclusion in the HQLA is identified as soon as is practicable; and

(c) without prejudice to the generality of section 27, prompt action is taken to exclude from the HQLA an asset identified as referred to in paragraph (b).

(2) A category 1 institution must have in place and maintain adequate systems to manage the foreign exchange risk associated with its HQLA, including—

(a) managing the institution's ability to access relevant foreign exchange markets for the transfer of liquidity from one currency to another;

(b) managing the institution's HQLA so that the HQLA is able to generate liquidity to meet the institution's total net cash outflows in different currencies; and

(c) subject to Division 4, managing the composition of its HQLA by currency so that the HQLA is broadly consistent with the distribution of the institution's total net cash outflows by currency.

29. HQLA must have diversification of classes of assets, etc.

(1) A category 1 institution must—

(a) have in place and maintain adequate policies and limits to control the level of concentration of HQLA within asset classes with respect to type of asset, type of issue, type of issuer and, without prejudice to the generality of section 28(2)(c), type of currency; and

(b) subject to subsection (2), ensure that its HQLA is well diversified within each of the asset classes comprising the HQLA.

(2) Subsection (1)(b) does not apply to a level 1 asset included in a category 1 institution's HQLA if the asset falls within any of the following types of asset—

(a) qualifying debt securities issued by the sovereign or central bank of the jurisdiction in which the institution is incorporated;

(b) qualifying debt securities issued by the sovereign or central bank of the jurisdiction in which the institution operates;

(c) central bank reserves;

(d) currency notes and coins; or

(e) EF debt securities.

30. General exclusion of assets from HQLA, etc.

(1) The Monetary Authority may, by notice in writing to all category 1 institutions, specify that a category 1 institution must not include in its HQLA, with effect from the date, or the occurrence of an event, specified in the notice, an asset, or a class of assets, of the type specified in the notice, on the ground that the Monetary Authority is satisfied that that type of asset or class of assets, as the case may be, is not, or is no longer, sufficiently liquid in private markets or readily monetizable by other means to be included in any category 1 institution's HQLA.

(2) Every category 1 institution must comply with the requirements of a notice given to it under subsection (1).

31. Specific exclusion of assets from HQLA, etc.

(1) The Monetary Authority may, by notice in writing to a category 1 institution, require the institution, with effect from the date, or the occurrence of an event, specified in the notice—

(a) to cease to include in its HQLA the asset specified in the notice on the ground that the Monetary Authority is satisfied that it no longer satisfies, or has never satisfied, the liquidity requirement rule specified in the notice that is applicable to the inclusion of that asset in its HQLA; or

(b) without prejudice to the generality of sections 28(2) and 29(1), to make the changes specified in the notice to its HQLA on the ground that the Monetary Authority is satisfied that those changes are necessary in order to mitigate the risks associated with the institution's failure, specified in the notice, to comply with section 28(2) or 29(1).

(2) A category 1 institution must comply with the requirements of a notice given to it under subsection (1).

32. Provisions supplementary to section 26

(1) The Monetary Authority may, after consultation with the Financial Secretary, the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, The Hong Kong Association of Banks and The DTC Association, and if satisfied that it is prudent and reasonable to do so in the prevailing financial circumstances, by notice in writing to all category 1 institutions, specify that a category 1 institution may include in its HQLA, with effect from the date, or the occurrence of an event, specified in the notice, a relevant asset specified in the notice if the institution and the relevant asset comply with—

(a) the prevailing banking supervisory standards issued by the Basel Committee relating to the inclusion of the relevant asset in HQLA; and

(b) the conditions (if any) specified in the notice relating to the inclusion of the relevant asset in HQLA.

(2) If a category 1 institution includes a relevant asset in its HQLA in accordance with a notice under subsection (1), the institution must construe, with all necessary modifications, the other requirements of these Rules in a manner consistent with the inclusion of that asset in its HQLA.

(3) In this section—

relevant asset ( ) means an asset (which may be an off-balance sheet asset), or an asset which falls within a class of assets (which may be a class of off-balance sheet assets), of a type which—

(a) under the prevailing banking supervisory standards issued by the Basel Committee relating to the inclusion of assets in HQLA, may be included in HQLA; and

(b) the other provisions of these Rules do not presently permit to be included in HQLA.

Division 3—Determination of HQLA - general

33. General requirements applicable to determination of HQLA

Subject to sections 34 to 39, a category 1 institution must determine the total weighted amount of its HQLA—

(a) subject to paragraphs (b), (c) and (d), as the sum of the total weighted amounts of its level 1 assets, level 2A assets and level 2B assets, calculated in accordance with section 36;

(b) if any of its level 1 assets, level 2A assets or level 2B assets are not available to the institution on the first day of the LCR period concerned, by excluding the asset concerned from its HQLA for that period and irrespective of the asset's remaining maturity;

(c) so that the sum of—

(i) the total weighted amount of level 2A assets; and

(ii) the total weighted amount of level 2B assets,

does not exceed 40% of the total weighted amount of its HQLA (**40% ceiling**); and

(d) so that the total weighted amount of level 2B assets does not exceed 15% of the total weighted amount of its HQLA (**15% ceiling**).

34. Calculation of total weighted amount of HQLA (without reversal of relevant securities financing transaction)

(1) Subject to section 35, a category 1 institution must, for the purposes of section 33, calculate the total weighted amount of its HQLA by the use of Formula 1.

Formula 1

Calculation of total weighted amount of HQLA

Total weighted amount of HQLA = total weighted amount of level 1 assets + total weighted amount of level 2A assets + total weighted amount of level 2B assets – adjustment for 15% ceiling – adjustment for 40% ceiling

Where—

adjustment for 15% ceiling = Max (level 2B assets – 15/85* (level 1 assets + level 2A assets), level 2B assets – 15/60* level 1 assets, 0);

adjustment for 40% ceiling = Max ((level 2A assets + level 2B assets – adjustment for 15% ceiling) – 2/3* level 1 assets, 0);

level 1 assets = total weighted amount of level 1 assets calculated in accordance with section 36(1)(a);

level 2A assets = total weighted amount of level 2A assets calculated in accordance with section 36(1)(b); and

level 2B assets = total weighted amount of level 2B assets calculated in accordance with section 36(1)(c).

(2) To avoid doubt, a category 1 institution must comply with subsection (1) only after all haircuts required by section 36 have been made to the institution's HQLA.

35. Calculation of total weighted amount of HQLA (if there is relevant securities financing transaction)

(1) Subsection (2) applies to a category 1 institution if—

(a) the institution has entered into a securities financing transaction that matures within the LCR period concerned and the transaction involves the exchange, during that period, of an HQLA qualifying asset of the institution for another HQLA qualifying asset from the counterparty to the transaction;

(b) the HQLA qualifying asset from the counterparty satisfies, or will satisfy when it is given to the institution, all the requirements of section 26(b) and (c) applicable to the asset; and

(c) the institution satisfies, or will satisfy when it is given the HQLA qualifying asset from the counterparty, all the requirements of section 26(d) applicable to the institution in so far as those requirements relate to that asset.

(2) If this subsection applies to a category 1 institution by virtue of subsection (1), the institution must—

(a) by the use of Formula 2, calculate the total weighted amount of HQLA after the reversal of the relevant securities financing transaction concerned; and

(b) take the lower amount of the 2 amounts calculated under section 34 and paragraph (a) as the total weighted amount of HQLA for the purposes of section 33.

Formula 2

Calculation of total weighted amount of HQLA (adjusted for the reversal of any relevant securities financing transaction)

Total weighted amount of HQLA = total weighted amount of level 1 assets + total weighted amount of level 2A assets + total weighted amount of level 2B assets – adjustment for 15% ceiling – adjustment for 40% ceiling,

Where—

adjustment for 15% ceiling = Max (adjusted level 2B assets – 15/85* (adjusted level 1 assets + adjusted level 2A assets), adjusted level 2B assets – 15/60* adjusted level 1 assets, 0);

adjustment for 40% ceiling = Max ((adjusted level 2A assets + adjusted level 2B assets – adjustment for 15% ceiling) – 2/3*adjusted level 1 assets, 0);

adjusted level 1 assets = total weighted amount of level 1 assets adjusted for the reversal of any relevant securities financing transaction involving the exchange by the category 1 institution of any level 1 asset, level 2A asset or level 2B asset for receipt by the category 1 institution from the counterparty of any level 1 asset within the LCR period concerned;

adjusted level 2A assets = total weighted amount of level 2A assets adjusted for the reversal of any relevant securities financing transaction involving the exchange by the category 1 institution of any level 1 asset, level 2A asset or level 2B asset for receipt by the category 1 institution from the counterparty of any level 2A asset within the LCR period concerned; and

adjusted level 2B assets = total weighted amount of level 2B assets adjusted for the reversal of any relevant securities financing transaction involving the exchange by the category 1 institution of any level 1 asset, level 2A asset or level 2B asset for receipt by the category 1 institution from the counterparty of any level 2B asset within the LCR period concerned.

(3) To avoid doubt, a category 1 institution to which subsection (2) applies must comply with that subsection only after all haircuts required by section 36 have been made to the institution's HQLA.

36. Haircuts

(1) Subject to section 39, for the purposes of section 33—

(a) the total weighted amount of level 1 assets is the sum of the weighted amount of assets that fall within each of the asset subclasses specified in column 1 of Table 1 under the asset class of level 1 assets, calculated by multiplying the principal amount of assets that fall within each of those asset subclasses by the post-haircut factor specified in the second column of Table 1 in relation to each of those subclasses;

(b) the total weighted amount of level 2A assets is the sum of the weighted amount of assets that fall within each of the asset subclasses specified in column 1 of Table 1 under the asset class of level 2A assets, calculated by multiplying the principal amount of assets that fall within each of those asset subclasses by the post-haircut factor specified in the second column of Table 1 in relation to each of those subclasses; and

(c) the total weighted amount of level 2B assets is the sum of the weighted amount of assets that fall within each of the asset subclasses specified in column 1 of Table 1

under the asset class of level 2B assets, calculated by multiplying the principal amount of assets that fall within each of those asset subclasses by the post-haircut factor specified in the second column of Table 1 in relation to each of those subclasses.

Table 1

Post-haircut Factors

1	2
Asset class/asset subclass	**Post-haircut factor**
Level 1 assets	
Currency notes and coins referred to in section 1(a) of Part 1 of Schedule 2	100%
Central bank reserves referred to in section 1(b) of Part 1 of Schedule 2	100%
Marketable debt securities referred to in section 1(c) of Part 1 of Schedule 2	100%
Marketable debt securities referred to in section 1(d) of Part 1 of Schedule 2	100%
Marketable debt securities referred to in section 1(e) of Part 1 of Schedule 2	100%
Level 2A assets	
Marketable debt securities referred to in section 2(a) of Part 1 of Schedule 2	85%
Marketable debt securities referred to in section 2(b) of Part 1 of Schedule 2	85%
Covered bonds referred to in section 2(c) of Part 1 of Schedule 2	85%
Level 2B assets	
Marketable debt securities referred to in section 3(a) of Part 1 of Schedule 2	50%
Approved RMBS	75%

(2) Subject to subsection (3), the principal amount of all subclasses of assets listed in Table 1 is the fair value of the subclass concerned.

(3) The principal amount of the asset subclasses of currency notes and coins and central bank reserves listed in Table 1 is the book value of the subclass concerned.

Division 4—Determination of HQLA—requirements applicable to category 1 institutions that use HQLA denominated in foreign currencies to cover portion of total net cash outflows denominated in Hong Kong dollars

37. Interpretation—Division 4

In this Division—

foreign currency-denominated HQLA ( ), in relation to the calculation by a category 1 institution of its LCR, means the total weighted amount of HQLA held by the institution, as determined in accordance with Part 7 before making any adjustment in respect of the 40% ceiling and 15% ceiling referred to in section 33, that are denominated in foreign currencies;

foreign currency-denominated total net cash outflows ( ), in relation to the calculation by a category 1 institution of its LCR, means the institution's total net cash outflows, as calculated in accordance with Division 5 of Part 7 before the application of section 41(2) to those outflows, that are denominated in foreign currencies;

HKD-denominated HQLA ( ), in relation to the calculation by a category 1 institution of its LCR, means the total weighted amount of HQLA held by the institution, as determined in accordance with Part 7 before making any adjustment in respect of the 40% ceiling and 15% ceiling referred to in section 33, that are denominated in Hong Kong dollars;

HKD-denominated total net cash outflows ( ), in relation to the calculation by a category 1 institution of its LCR, means the institution's total net cash outflows, as calculated in accordance with Division 5 of Part 7 before the application of section 41(2) to those outflows, that are denominated in Hong Kong dollars;

HKD LCR mismatch ( ), in relation to the calculation by a category 1 institution of its LCR, means that portion of the institution's HKD-denominated total net cash outflows that is not covered by its HKD-denominated HQLA;

HKD LCR mismatch ratio ( ), in relation to the calculation by a category 1 institution of its LCR, means the ratio, expressed as a percentage, of the institution's HKD LCR mismatch to its HKD-denominated total net cash outflows;

relevant portion ( ), in relation to the calculation by a category 1 institution of its LCR, is to be construed in accordance with section 39;

section 38 institution ( ) means a category 1 institution that uses, or is proposing to use, HQLA denominated in foreign currencies to cover the institution's HKD LCR mismatch in the calculation of its LCR under section 38.

38. Circumstances and requirements under which category 1 institution may use HQLA denominated in foreign currencies to cover HKD LCR mismatch

Without prejudice to the generality of section 28(2)(c) but subject to section 39, a category 1 institution may use HQLA denominated in foreign currencies to cover its HKD LCR mismatch in the calculation of its LCR only if—

(a) the institution can demonstrate to the satisfaction of the Monetary Authority that it has a genuine need to use such HQLA to comply with section 5;

(b) such HQLA are level 1 assets and have not already been used by the institution to cover its foreign currency-denominated total net cash outflows;

(c) the institution applies the haircuts required under section 39 to such HQLA;

(d) the use of such HQLA (after applying the haircuts required under section 39) does not result in the institution holding level 1 assets denominated in Hong Kong dollars that is less than 20% of its HKD-denominated total net cash outflows; and

(e) the institution can demonstrate to the satisfaction of the Monetary Authority that it has the necessary systems and capacity to manage the level of foreign exchange risk associated with the use of such HQLA.

39. Application of foreign exchange haircuts

(1) Subject to subsection (2), a section 38 institution, in determining the institution's total weighted amount of HQLA for the purposes of section 33, must deduct from the total weighted amount of its HQLA an amount calculated by multiplying the principal amount of the level 1 assets constituting that portion of foreign currency-denominated HQLA held by the institution to cover its HKD LCR mismatch (***relevant portion***) by the haircut required by Table 2 applicable to those assets.

Table 2

Item no.	Type of foreign currency	Haircut
1.	Level 1 assets denominated in US dollars	2%
2.	Level 1 assets denominated in euro, pound sterling and Japanese yen	8%
3.	Level 1 assets denominated in any other foreign currency that is freely convertible into Hong Kong dollars	10%

(2) Subsection (1) does not apply to the relevant portion (or that part of the relevant portion) of foreign currency-denominated HQLA held by a section 38 institution that is not more than 25% of the institution's HKD-denominated total net cash outflows.

Division 5—Calculation of Total Net Cash Outflows

40. Interpretation—Division 5

In this Division—

cash management services ( ), in relation to a category 1 institution, means any services provided by the institution that directly or indirectly enable its customers to manage their cash flows, assets and liabilities, or to conduct financial transactions necessary for their ongoing operations, in relation to payment remittances, the collection and aggregation of funds, payroll administration or control over the disbursement of funds;

clearing services ( ), in relation to a category 1 institution, means services provided by the institution that enable its customers to transfer funds or assets indirectly through direct participants in settlement systems to final recipients, but such services are limited to the transmission, reconciliation or confirmation of payment orders, daylight overdrafts or overnight financing, the maintenance of post-settlement balances or the determination of intraday and end-of-day settlement positions;

committed facility ( ), in relation to a category 1 institution, means a contractual agreement between the institution and its customer whereby the institution has a contractually irrevocable commitment to extend funds to the customer at a future date, whether for credit or liquidity purposes, in accordance with the terms and conditions specified in the agreement;

committed liquidity facility ( ), in relation to a category 1 institution, means a committed facility that serves as a standby facility granted by the institution to its customer to refinance the customer's debt obligations (for example, pursuant to a commercial paper programme) in situations where the customer is unable to refinance those debt obligations in financial markets;

correspondent banking services ( ) means services under which a correspondent bank holds deposits and other funding from a respondent bank for the clearing and

settlement of transactions in a currency other than the currency of the jurisdiction in which the respondent bank is incorporated or operates;

custodial and safekeeping services ( ), in relation to a category 1 institution, means services provided by the institution for the safekeeping, processing and reporting of assets on behalf of its customers, or for the facilitation, on behalf of its customers, of operational and administrative arrangements, but such services are limited to the safekeeping, processing and reporting of assets, in relation to the settlement of transactions involving securities, the transfer of contractual payments, the processing of collateral, the provision of custodial and safekeeping related cash management services, the receipt of dividends and other income, client subscriptions and redemption, asset and corporate trust servicing, treasury, escrow, fund transfer, stock transfer or agency services (including payment and settlement services not related to correspondent banking services) or depository receipts;

effective deposit insurance scheme ( ) means—

(a) the Deposit Protection Scheme established under section 11 of the Deposit Protection Scheme Ordinance (Cap 581);

(b) a deposit insurance scheme—

(i) that has the ability to make prompt payouts of insured deposits;

(ii) for which the deposit coverage is clearly defined;

(iii) of which public awareness is high; and

(iv) in which the deposit insurer has formal legal powers to fulfil its mandate and is operationally independent, transparent and accountable; or

(c) an explicit and legally binding deposit guarantee provided by the sovereign in a jurisdiction that effectively functions as deposit insurance in that jurisdiction;

excess non-segregated collateral ( ), in relation to a category 1 institution, means the fair value of non-segregated collateral held by the institution that is—

(a) posted by the institution's counterparty under a derivative contract or other transaction; and

(b) in excess of the amount of collateral contractually required to be posted to the institution under that contract or transaction;

fully insured ( ), in relation to a deposit covered under an effective deposit insurance scheme, means that 100% of the deposit amount (up to the deposit coverage limit) is insured by the scheme;

fully performing ( ), in relation to an asset or exposure of a category 1 institution, means that the asset or exposure is not past due and has not been rescheduled;

less stable retail deposit ( ), in relation to a category 1 institution, means a retail deposit taken by that institution that is not a stable retail deposit or retail term deposit;

margin agreement ( ) has the meaning assigned to it by section 226A of the Capital Rules;

margin lending transaction ( ), in relation to a category 1 institution, means a secured lending transaction under which the institution extends a margin loan to its customer;

margin loan ( ), in relation to a category 1 institution, means a collateralized loan extended by the institution to its customer under a margin agreement in connection with the trading of securities by that customer;

material adverse event ( ), in relation to a derivative contract or other contract entered into by a category 1 institution with a counterparty, means an event specified in

the contract that relates to adverse changes in the institution's credit-worthiness or financial conditions (including a 3-notch downgrade in its ECAI issuer rating or a downgrade of such rating to a non-investment grade), the occurrence of which will require the institution to fulfil its obligations specified in the contract (which may include the payment of a sum of money or the posting of additional collateral) to the counterparty;

non-contractual contingent funding obligation ( ), in relation to a category 1 institution, includes, but is not limited to, an obligation of the institution that is—

(a) associated with the issue or sponsorship of financial instruments(including structured financial instruments), or the provision of financial services, that may necessitate the funding support of, or the extension of funds by, the institution in times of financial stress; or

(b) embedded in financial instruments (including structured financial instruments) originated, sponsored, marketed or sold by the institution that may render it necessary for the institution, out of reputation risk considerations, to repurchase those instruments from the holders of the instruments if there is a failure to satisfy the holders' reasonable expectations about the liquidity and marketability of the instruments;

non-segregated collateral ( ), in relation to a category 1 institution, means collateral posted by the institution's counterparty under a derivative contract or other transaction that is not segregated from other assets held by the institution;

operational deposit ( ), in relation to a category 1 institution, means a deposit placed, by a wholesale customer (other than a small business customer) of the institution, with the institution in the course of the institution providing to that customer operational services on which the customer has become significantly dependent for its business operation;

operational services ( ) mean customer clearing services, custodial and safekeeping services or cash management services other than correspondent banking services or prime brokerage services;

other contingent funding obligation ( ), in relation to a category 1 institution, means a contractual or non-contractual contingent funding obligation of the institution that is not-

(a) a lending commitment; and

(b) otherwise included in the calculation of total net cash outflows under the LCR in these Rules;

other contractual cash outflow ( ), in relation to a category 1 institution, means a contractual cash outflow of the institution (not being a contractual cash outflow relating to the operating expenses of the institution) that—

(a) may occur within the LCR period; and

(b) is not otherwise included in the calculation of total net cash outflows under the LCR in these Rules;

other established relationship ( ), in relation to a category 1 institution, means a banking relationship between the institution and a customer of the institution, other than the placing of deposits with the institution, in relation to loans, credit cards, investments or wealth management accounts;

prime brokerage services ( ), in relation to a category 1 institution, means any services provided by the institution to institutional or professional investors to facilitate their investment and trading activities;

rescheduled ( ) has the meaning assigned to it by section 51(1) of the Capital Rules;

retail customer ( ), in relation to a category 1 institution, means a customer of the institution who is a natural person;

retail deposit ( ), in relation to a category 1 institution, means a deposit taken by the institution from a retail customer;

retail term deposit ( ), in relation to a category 1 institution, means a retail deposit, taken by the institution from a retail customer, that has a remaining term to maturity, or a withdrawal notice period, greater than the LCR period, and in respect of which—

(a) the retail customer has no legal right to withdraw the deposit within the LCR period; or

(b) any early withdrawal of the deposit will result in the retail customer being charged a significant penalty that is materially greater than the loss of interest that may arise from the early withdrawal;

secured funding ( ), in relation to a secured funding transaction entered into by a category 1 institution with a counterparty, means the institution's liability or obligation to the counterparty under the transaction in which the counterparty's exposure is collateralized by its legal right to a designated asset (or a designated pool of assets) owned by the institution in the case of the default, bankruptcy, insolvency, liquidation or resolution of the institution;

secured funding transaction ( ), in relation to a category 1 institution, means a securities repurchase transaction or securities lending transaction, or other similar transaction, entered into by the institution with a counterparty who provides a sum of money or other securities to the institution on a collateralized basis;

secured lending ( ), in relation to a secured lending transaction entered into by a category 1 institution with a counterparty, means the institution's exposure to the counterparty under the transaction which is collateralized by the institution's legal right to a designated asset (or a designated pool of assets) owned by the counterparty in the case of the default, bankruptcy, insolvency, liquidation or resolution of the counterparty;

secured lending transaction ( ), in relation to a category 1 institution, means a securities reverse repurchase transaction or securities borrowing transaction, margin lending transaction, or other similar transaction, entered into by the institution with a counterparty in which the institution provides a sum of money or other securities to the counterparty on a collateralized basis;

securities borrowing transaction ( ), in relation to a category 1 institution, means a repo-style transaction entered into by the institution whereby the institution borrows securities from a counterparty and provides a sum of money or other securities to the counterparty in exchange as collateral;

securities lending transaction ( ), in relation to a category 1 institution, means a repo-style transaction entered into by the institution whereby the institution lends securities to a counterparty and receives a sum of money or other securities from the counterparty in exchange as collateral;

securities repurchase transaction ( ), in relation to a category 1 institution, means a repo-style transaction entered into by the institution whereby the institution agrees to sell securities to a counterparty for a sum of money with a commitment to repurchase the securities, at a specified price and on a specified future date, from the counterparty;

securities reverse repurchase transaction ( ), in relation to a category 1 institution, means a repo-style transaction entered into by the institution whereby the institution agrees to acquire securities from a counterparty for a sum of money with a commitment

to resell the securities, at a specified price and on a specified future date, to the counterparty;

securities swap transaction ( ), in relation to a category 1 institution, means—

(a) a securities lending transaction whereby the institution lends securities to a counterparty and receives other securities from the counterparty in exchange as collateral; or

(b) a securities borrowing transaction whereby the institution borrows securities from a counterparty and provides other securities to the counterparty in exchange as collateral;

small business customer ( ), in relation to a category 1 institution, means a corporate (or, if applicable, a group of related corporates) which has provided the institution with total aggregated funding of less than 10 million Hong Kong dollars (or its equivalent in another currency), and in respect of which—

(a) if the institution has a credit exposure to the corporate (or group), the credit exposure meets the criteria for the IRB subclass of small business retail exposures under section 144 of the Capital Rules; or

(b) if the institution has no credit exposure to the corporate (or group), that aggregated funding is managed by the institution as if it were a retail deposit;

small business funding ( ), in relation to a category 1 institution, means unsecured wholesale funding provided to the institution by small business customers;

stable retail deposit ( ), in relation to a category 1 institution, means a retail deposit taken by the institution from a retail customer and that is payable on demand, or has a remaining term to maturity (or a withdrawal notice period) within the LCR period, where—

(a) the deposit is fully insured by an effective deposit insurance scheme;

and

(b) either—

(i) the retail customer has at least 2 other established relationships with the institution, in which—

(A) subject to clause (B), at least one of the relationships (but not that of a credit card account) has been established for not less than 6 months and the account underlying that relationship has not been dormant or inactive in the last 6 months; and

(B) the requirement in clause (A) is deemed to be met if the relationship relates to a mortgage loan that charges a penalty for early settlement of the loan within 6 months from the date that the loan is drawn down;

or

(ii) the deposit is maintained by the retail customer in a transactional account at the institution;

structured financing transaction ( ) means a collateralized transaction involving the issue of a structured financial instrument in which the repayment of obligations and other exposures to the transaction is largely derived, directly or indirectly, from the cash flows generated by the pool of underlying assets that secures the obligations and other exposures to the transaction;

total aggregated funding ( ), in relation to a small business customer (or, if applicable, a group of related small business customers) of a category 1 institution, means the gross amount of funding (including any deposit or other form of funding) provided to the institution by the customer (or the group as if it were a single customer);

total net cash outflows ( ), in relation to a category 1 institution, means the institution's total expected cash outflows, after deduction of its total expected cash inflows, calculated in accordance with Division 5 of Part 7;

transactional account ( ), in relation to a category 1 institution, means a deposit account maintained at the institution which is designated by the account-holder to receive funds or make payments on a regular basis;

uncommitted facility ( ), in relation to a category 1 institution, means a facility granted by the institution to its customer that—

(a) is for the purposes of extending credit or providing liquidity to the customer; and

(b) is unconditionally revocable by the institution without prior notice to the customer.

unsecured wholesale funding ( ), in relation to a category 1 institution, means a deposit or other liability—

(a) from or to, as the case may be, a person other than a natural person; and

(b) that is not collateralized by a legal right to any designated asset owned by the institution in the case of the bankruptcy, insolvency, liquidation or resolution of the institution;

wholesale customer ( ), in relation to a category 1 institution, means a customer of the institution other than a retail customer.

41. Calculation of total net cash outflows

(1) A category 1 institution must, in calculating its total net cash outflows under the LCR—

(a) calculate its total expected cash outflows, in accordance with section 42, by aggregating the principal amounts of its on-balance sheet liabilities or off-balance sheet obligations, each respectively multiplied by the applicable rate at which the type of on-balance sheet liability or off-balance sheet obligation, as the case may be, concerned is expected to run off or be drawn upon within the LCR period;

(b) subject to subsection (2), calculate, in accordance with section 43, its total expected cash inflows by aggregating the principal amounts of its assets (whether on-balance sheet or off-balance sheet), each respectively multiplied by the applicable rate at which the type of asset concerned is expected to flow in within the LCR period; and

(c) deduct its total expected cash inflows calculated under paragraph (b) from its total expected cash outflows calculated under paragraph (a).

(2) A category 1 institution's total expected cash inflows calculated under subsection (1)(b) must not be more than 75% of the institution's total expected cash outflows calculated under subsection (1)(a).

(3) To avoid doubt, the principal amount of a liability or asset referred to in subsection (1) which is not measured at fair value means the book value of the liability or asset, including the accrued interest of the liability or asset, as the case may be.

42. Calculation of total expected cash outflows

(1) A category 1 institution must, for the purposes of section 41(1)(a), calculate its expected cash outflow within the LCR period arising from the following types of on-balance sheet liability or off-balance sheet obligation of the institution:

(a) stable retail deposits;

(b) less stable retail deposits;

(c) retail term deposits;

(d) small business funding;

(e) operational deposits;

(f) unsecured wholesale funding (other than operational deposits) provided by corporates (other than small business customers), sovereigns, the Monetary Authority for the account of the Exchange Fund, central banks, multilateral development banks and public sector entities;

(g) unsecured wholesale funding other than funding covered under paragraphs (d) to (f);

(h) debt securities and prescribed instruments issued by the institution and redeemable within the LCR period;

(i) secured funding (including liabilities or obligations arising from securities swap transactions);

(j) liabilities or obligations arising from derivative contracts;

(k) other liabilities or obligations arising from derivative contracts or other transactions, including any additional expected cash outflow to cover liquidity risk arising from the following situations:

(A) derivative contracts or other transactions with material adverse event clauses;

(B) potential loss in the market value of collateral posted by the institution to its counterparty;

(C) holding of excess non-segregated collateral posted by the institution's counterparty who has the right to withdraw the excess collateral from the institution;

(D) holding of non-segregated collateral posted by the institution's counterparty-

(I) that qualifies for inclusion as HQLA under the LCR (***HQLA collateral***); and

(II) whereby the counterparty has a contractual right to substitute the posted HQLA collateral by one or more types of collateral that qualify as HQLA at a lower level or do not qualify as HQLA;

(E) contractual obligation of the institution to post collateral to its counterparty;

(F) increase in collateral needs under derivative contracts or other transactions that are subject to collateral requirements arising from adverse changes in the market value of such contracts or transactions;

(G) repayment of funding obtained from structured financial instruments issued by the institution and redeemable within the LCR period; and

(H) obligations under structured financing transactions for repayment of maturing debt or provision of funding or asset that may arise from any embedded option in such transactions;

(l) drawdown of undrawn committed facilities (including committed credit facilities and committed liquidity facilities);

(m) contractual [lending][2] obligations to the Monetary Authority for the account of the Exchange Fund, central banks and financial institutions not otherwise covered in this subsection;

[2] The HKMA is seeking clarification from the Basel Committee on whether this cash outflow item should be confined to "lending" obligations or a broader meaning of "funding" obligations.

(n) contractual [lending] obligations to the institution's retail customers and other customers that are not otherwise covered in this subsection, the aggregate amount of which exceeds 50% of total contractual payment obligations from the same types of customer to the institution;

(o) other contingent funding obligations; and

(p) other contractual cash outflows.

(2) Subject to subsections (3) and (4), a category 1 institution may exclude a pledged deposit from the calculation of its total expected cash outflows if—

(a) the deposit is pledged as collateral against a loan which will not be settled within the LCR period;

(b) the pledge arrangement concerned is subject to a legally enforceable contract that effectively disallows withdrawal of the deposit before the loan is fully settled; and

(c) the amount of deposit to be excluded from the calculation does not exceed the outstanding balance of the loan.

(3) If a pledged deposit is pledged as collateral against an undrawn credit facility—

(a) subsection (2) does not apply to the deposit; and

(b) the category 1 institution must, in the calculation of its total expected cash outflows in so far as the calculation relates to that deposit and facility, use the higher of the outflow rates that are respectively applicable to the deposit or facility as if the deposit were not a pledged deposit.

(4) If a pledged deposit is pledged as collateral against a partially drawn credit facility, then

(a) subsection (2) only applies to the drawn portion of the facility; and

(b) subsection (3) only applies to the undrawn portion of the facility.

(5) Subject to subsections (6) and (7), a category 1 institution must account for any type of funding it has obtained in the calculation of its total expected cash outflows if—

(a) the funding is callable by the fund provider within the LCR period;

(b) the earliest possible contractual maturity date of the funding falls within the LCR period; or

(c) the funding is either payable on demand or does not have a specific maturity date.

(6) If—

(a) the funding obtained by the category 1 institution is callable at its option within the LCR period; and

(b) there is market expectation that the institution will exercise that option and thus cause that funding to be redeemed before its contractual maturity date,

the institution must include the funding in the calculation of its total expected cash outflows as if the funding will be redeemed within the LCR period.

(7) Subsection (5) does not apply to funding that is callable by the fund provider subject to a contractually defined and legally binding notice period that extends beyond the LCR period.

(8) A category 1 institution must, for the purposes of section 41(1)(a), calculate its total expected cash outflows by multiplying the principal amount of each of its on-balance sheet liabilities and off-balance sheet obligations of the types listed in subsection (1) by an outflow rate determined in accordance with subsection (9), using the standard calculation methodology templates specified by the Monetary Authority .

(9) Subject to subsections (10) and (11), the outflow rate (and the manner of its application) for each type of on-balance sheet liability or off-balance sheet obligation listed in

subsection (1) must be consistent with, and no less stringent than, the relevant outflow rate (or any other term having a similar denotation) referred to in paragraphs 73 to 141 of the document entitled "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools" published by the Basel Committee in January 2013 (***the Basel III LCR document)***.

(10) In the case of on-balance sheet liabilities or off-balance sheet obligations (other than non-contractual contingent funding obligations included in paragraph (n) of subsection (1)), where –

(a) the applicable outflow rate is to be determined by the relevant banking supervisory authority in a jurisdiction and hence is not specified in the Basel III LCR document; or

(b) the Monetary Authority is satisfied that having regard to the prevailing circumstances in Hong Kong, it is prudent and reasonable to apply a higher outflow rate than that specified in the Basel III LCR document,

a category 1 institution must apply the outflow rates specified in Table 3 to those liabilities or obligations.

Table 3

Outflow rates for calculation of expected cash outflow arising from on-balance sheet liabilities or off-balance sheet obligations referred to in this subsection

Section 42(1) reference	Type of on-balance sheet liability or off-balance sheet obligation	Outflow rate
para. (b)	Less stable retail deposits	10%
para. (c)	Retail term deposits	5%
para. (o)	Other contingent funding obligations	
	1. Trade-related contingencies	3%
	2. Guarantees and letters of credit unrelated to trade-related contingencies	10%
	3. Uncommitted facilities	0%
	4. Non-contractual contingent funding obligations arising from— (a) debt securities or structured financial instruments with a maturity date beyond the LCR period , in respect of which a category 1 institution (or its associated entity) is the issuer, a market maker or a dealer, or has been involved as an originator, sponsor, marketing agent or seller; or (b) money market funds or other types of collective investment funds marketed by a category 1 institution (or its associated entity), where there is a reasonable expectation that the obligations will be materialized within the LCR period	100%

(11) In the case of a category 1 institution's non-contractual contingent funding obligations within paragraph (o) of subsection (1) related to potential liquidity draws by a joint venture or by an entity—

(a) in which the institution has a minority interest;

(b) which is not consolidated for the purposes of section 12(1); and

(c) where there is a reasonable expectation that the institution will be the main provider of liquidity should the joint venture or entity concerned be in need of liquidity,

the institution must agree an outflow rate with the Monetary Authority on a case by case basis (failing which the Monetary Authority will specify an outflow rate of not more than 100% by reference to an assessment of the liquidity risk to which the institution is exposed).

43. Calculation of total expected cash inflows

(1) A category 1 institution must, in calculating its total expected cash inflows under section 41(1)(b)—

(a) include only contractual cash inflows (including any accrued interest) that—

(i) are expected to be received within the LCR period; and

(ii) arise from assets (whether on-balance sheet assets or off-balance sheet assets) that are fully performing and in respect of which the institution has no reason to expect a default within the LCR period;

(b) assume that those inflows are received by the institution at the latest possible date based on contractual rights available to its customers; and

(c) not include any cash inflows that are contingent in nature.

(2) A category 1 institution must, for the purposes of section 41(1)(b), calculate its expected cash inflow within the LCR period arising from the following types of asset (whether on-balance sheet or off balance sheet), transaction or activity of the institution—

(a) secured lending transactions (including securities swap transactions);

(b) secured or unsecured loans (other than those that fall within paragraph (a));

(c) release of balances maintained by the institution in segregated accounts in accordance with requirements for protection of customer assets;

(d) maturing securities not included by the institution in its HQLA;

(e) undrawn facilities granted to the institution by another financial institution;

(f) operational deposits placed by the institution at other financial institutions;

(g) derivative contracts; and

(h) other contractual cash inflows arising from assets, transactions or activities not otherwise covered in this subsection.

(3) A category 1 institution must, for the purposes of section 41(1)(b), calculate its total expected cash inflows by multiplying the principal amount of each of its assets (whether on-balance sheet or off-balance sheet) of the types listed in subsection (2) by an inflow rate determined in accordance with subsection (4), using the standard calculation methodology templates specified by the Monetary Authority.

(4) Subject to subsections (5) and (6), the inflow rate (and the manner of its application) for each type of asset listed in subsection (2) must be consistent with, and no less stringent than, the relevant inflow rate (or any other term having a similar denotation) referred to in paragraphs 142 to 160 of the Basel III LCR document.

(5) In the case of contractual cash inflows included in paragraph (h) of subsection (2), where the applicable inflow rate is to be determined by the relevant banking supervisory authority in a jurisdiction and hence is not specified in the Basel III LCR document, a category 1 institution must apply the inflow rates specified in Table 4 to those cash inflows.

Table 4

Inflow rates for calculation of expected cash inflow applicable to other contractual cash inflows included in paragraph (h) of subsection (2)

Type of other contractual cash inflow	Inflow rate
Other contractual cash inflow to be received from—	
(a) the Monetary Authority for the account of the Exchange Fund, central banks and financial institutions	100%
(b) retail customers or small business customers	50%
(c) sovereigns, public sector entities, multilateral development banks, wholesale customers (excluding small business customers), or any other persons not falling within paragraph (a) or (b)	50%

(6) A category 1 institution must have in place and maintain—

(a) adequate policies and limits to ensure that its liquidity position is not unduly reliant on the receipt of expected cash inflows from a limited number of wholesale customers; and

(b) adequate policies and systems for managing assets received as collateral from its counterparties under secured lending transactions so that it is able to fulfil any contractual obligation under those transactions to return one or more of those assets to the counterparty concerned whenever the counterparty decides not to renew the secured lending transaction concerned upon its maturity.

Part 8

Calculation of LMR

Division 1—General

44. Interpretation—Part 8

In this Part—

average LMR ( ), in relation to a category 2 institution, means the average of the institution's LMR in a calendar month, as determined in accordance with section 49;

eligible loan repayment ( ), in relation to the calculation by a category 2 institution of its LMR, means a repayment—

(a) to the institution by a customer (other than a bank) in respect of a loan—

(i) that the institution is not committed to continue, by renewal or otherwise; and

(ii) that is fully performing;

(b) the date of which is fixed;

(c) that will fall due within one month;

(d) in respect of which the institution has no reason to expect a default; and

(e) if the loan referred to in paragraph (a) is secured by a pledged deposit referred to in section 54(1)—

(i) in the case where the loan will be fully repaid after receiving that repayment, consisting only of that part of the repayment that exceeds the aggregate of the deposit and interest payable on the deposit;

(ii) in the case where the loan will not be so fully repaid, consisting only of that repayment in so far as it is not made by a corresponding reduction of the amount of the deposit or interest payable on the deposit, or both (but excluding any repayment in respect of mortgage loans referred to in item no. 7 of Table A1 in Schedule 5);

fully performing ( ), in relation to a loan extended by a category 2 institution and the definition of ***eligible loan repayment***, means that—

(a) if the loan is repayable by periodic instalments at intervals of not more than one month, there is no instalment that is in arrears for more than one month on the working day when the LMR is calculated;

(b) in any other case, there are no arrears of principal or interest payment in respect of the loan; and

(c) the loan (***relevant loan***) is not a loan that has been raised to repay another loan granted to the same customer by the institution; or in respect of which the repayment date or dates has or have been postponed, unless—

(i) the raising of the relevant loan or the postponement of the repayment date or dates, as the case may be, was not caused by a deterioration in the financial position of the customer or by his inability to repay on the original repayment date or dates; and

(ii) the new or revised repayment terms are not unfavourable to the institution as compared to the terms of other loans, of a similar nature to that of the relevant loan, granted by the institution to other customers and negotiated at arm's length;

one-month liability ( ), in relation to a category 2 institution or bank, means—

(a) any liability, other than a contingent liability, the effect of which will or could be to reduce within one month the liquefiable assets of that institution or bank; and

(b) any contingent liability that, in the opinion of the Monetary Authority, may result in a reduction within one month of the liquefiable assets of that institution or bank;

qualifying ECAI rating ( ), in relation to a marketable debt security or prescribed instrument, means—

(a) a qualifying ECAI issue specific rating assigned to the debt security or instrument; or

(b) a qualifying ECAI issuer rating assigned to the issuer or the guarantor of the debt security or instrument;

qualifying ECAI issuer rating ( ), in relation to a marketable debt security or prescribed instrument, means—

(a) subject to paragraph (b), the ECAI issuer rating of the issuer or guarantor that—

(i) if mapped to the scale of credit quality grades in Table A, Table B or Part 1 of Table C (in the case of a long-term ECAI issuer rating) in Schedule 6 to

the Capital Rules would result in the debt security or instrument being assigned a credit quality grade of 1 or 2;

(ii) if mapped to the scale of credit quality grades in Part 1 of Table E (in the case of a short-term ECAI issuer rating) in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1 or 2;

(b) if the debt security or instrument is issued or guaranteed by a corporate incorporated in India, the ECAI issuer rating of the issuer or guarantor that—

(i) if mapped to the scale of credit quality grades in Part 2 of Table C (in the case of a long-term ECAI issuer rating) in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1, 2 or 3;

(ii) if mapped to the scale of credit quality grades in Part 2 of Table E (in the case of a short-term ECAI issuer rating) in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1, 2 or 3;

qualifying ECAI issue specific rating ( ), in relation to a marketable debt security or prescribed instrument, means—

(a) subject to paragraph (b), the ECAI issue specific rating of the debt security or instrument that—

(i) if mapped to the scale of credit quality grades in Table A, Table B or Part 1 of Table C (in the case of a long-term ECAI issue specific rating) in Schedule 6 to the Capital Rules would result in the debt security or instrument being assigned a credit quality grade of 1 or 2;

(ii) if mapped to the scale of credit quality grades in Part 1 of Table E (in the case of a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1 or 2;

(b) if the debt security or instrument is issued by a corporate incorporated in India, the ECAI issue specific rating of the debt security or instrument that—

(i) if mapped to the scale of credit quality grades in Part 2 of Table C (in the case of a long-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1, 2 or 3;

(ii) if mapped to the scale of credit quality grades in Part 2 of Table E (in the case of a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security or instrument being assigned a credit quality grade of 1, 2 or 3.

45. Assets, etc., must not be double counted in calculation of LMR

(1) A category 2 institution must not, in the calculation of its LMR, double count an asset, liability, off-balance sheet item, or associated cash flow, that is included in that calculation.

(2) Without prejudice to the generality of subsection (1), a category 2 institution must not, in the calculation of its LMR, deduct from its qualifying liabilities any cash inflow associated with an asset included in its liquefiable assets for the purposes of that calculation.

46. Calculation of LMR on Hong Kong office basis

A category 2 institution must, in the calculation of its LMR on a Hong Kong office basis, determine—

(a) its liquefiable assets held in its Hong Kong office; and

(b) the qualifying liabilities (after deductions) of its Hong Kong office,

as if its Hong Kong office were a single legal entity.

47. Calculation of LMR on unconsolidated basis

A category 2 institution incorporated in Hong Kong must, in the calculation of its LMR on an unconsolidated basis—

(a) determine the aggregate of its liquefiable assets held in its Hong Kong office and its overseas branches;

(b) determine the aggregate of the qualifying liabilities (after deductions) of its Hong Kong office and its overseas branches; and

(c) ensure that all inter-branch balances with, and transactions between, its Hong Kong office and its overseas branches are offset in that calculation.

48. Calculation of LMR on consolidated basis

(1) A category 2 institution incorporated in Hong Kong must, in the calculation of its LMR on a consolidated basis—

(a) determine the aggregate of its liquefiable assets held by the members of its consolidated group;

(b) determine the aggregate of the qualifying liabilities (after deductions) of the members of its consolidated group; and

(c) ensure that all inter-branch or inter-company balances with, and transactions between, the members of its consolidated group are offset in that calculation.

(2) A category 2 institution must comply with subsection (1) as if the members of its consolidated group were a single legal entity.

Division 2—Calculation of average LMR, liquefiable assets, qualifying liabilities, etc.

49. Calculation of average LMR in each calendar month

(1) Subject to subsection (2), a category 2 institution must, for the purposes of section 8, calculate, for each calendar month, its average LMR on the basis of the sum of the net weighted amount of its liquefiable assets, as determined in accordance with subsection (3), and the sum of the net weighted amount of its qualifying liabilities (after deductions), as determined in accordance with subsection (4), for each working day of that month.

(2) The Monetary Authority may, by notice in writing to a category 2 institution, permit the institution to calculate its average LMR by reference to such days during the month as the Monetary Authority specifies in the notice (and, if any such specified day is a public holiday, the immediately preceding working day must be taken to be that specified day for the purpose of that calculation).

(3) The net weighted amount of liquefiable assets of a category 2 institution is the total of the weighted amounts calculated in accordance with subsection (6) of each asset item specified in Table A1 of Schedule 5 held by the institution that meets the requirements

of section 50 applicable to that item, after deducting from that total the weighted amount calculated in accordance with subsection (6) of the deductible item specified in Table A2 of Schedule 5.

(4) The net weighted amount of qualifying liabilities (after deductions) of a category 2 institution is the difference between—

(a) the total of the weighted amounts calculated in accordance with subsection (6) of each qualifying liability item specified in Table B of Schedule 5; and

(b) subject to subsection (5), the total of the weighted amounts calculated in accordance with subsection (6) of each deductible item specified in Table C of Schedule 5.

(5) A category 2 institution's total weighted amount calculated under subsection (4)(b) must not be more than 75% of the institution's total weighted amount calculated under subsection (4)(a).

(6) The weighted amount of each item specified in Table A1, A2, B or C of Schedule 5 must be calculated by multiplying the principal amount of that item by the liquidity conversion factor specified in Table A1, A2, B or C respectively of Schedule 5 in relation to that item.

(7) For the purposes of subsection (6)—

principal amount ( )—

(a) in relation to an item that is gold bullion or a marketable debt security or prescribed instrument specified in Table A1 of Schedule 5, means the fair value of the item; and

(b) in relation to any other item specified in Table A2, B or C of Schedule 5, means the book value (including any accrued interest) of that item,

at the close of business on a working day.

50. Requirements that must be satisfied before asset can be included in liquefiable assets for purposes of calculation of LMR

(1) Subject to sections 52 and 53, a category 2 institution must not, in the calculation of its LMR, include an asset in its liquefiable assets unless the asset falls within a class of assets specified in Table A1 of Schedule 5 and meets the other qualifying criteria specified in subsection (2).

(2) The other qualifying criteria referred to in subsection (1) are—

(a) the asset must be easily and readily monetizable;

(b) the asset must not be overdue or in default;

(c) the asset must be free from encumbrances and there must be no legal, regulatory, contractual or other restrictions that inhibit the category 2 institution from liquidating, selling, transferring or assigning the asset;

(d) the value of the asset must be readily identifiable and measurable;

(e) the asset must be freely transferable and available to the category 2 institution and must not be subject to any liquidity transfer restriction;

(f) the asset must not be a subordinated debt security;

(g) if the asset is a structured financial instrument, the structure of the instrument must be simple and standardized; and

(h) the asset must be denominated in Hong Kong dollars or in a currency freely convertible into Hong Kong dollars.

(3) The Monetary Authority may, by notice in writing to a category 2 institution that has made an application to the Monetary Authority for the grant of an approval referred to in item no. 6(f) of Table A1 in Schedule 5, determine the application by—

(a) granting approval to the institution, with effect from the date, or the occurrence of an event, specified in the notice, to include the RMBS, other debt security or prescribed instrument specified in the notice in its liquefiable assets if the institution demonstrates to the satisfaction of the Monetary Authority that—

(i) that RMBS, other debt security or prescribed instrument meets the requirements set out in subsection (2) applicable to it; and

(ii) the inclusion of that RMBS, other debt security or prescribed instrument as a liquefiable asset would not prejudice the calculation of the LMR of the institution, having regard to the risks associated with holding that RMBS, other debt security or prescribed instrument; or

(b) if the Monetary Authority is not satisfied as referred to in paragraph (a), refusing to grant the approval and specifying in the notice the reasons why the Monetary Authority is not so satisfied.

(4) If the Monetary Authority grants an approval under subsection (3)(a) to a category 2 institution, the approval may be granted subject to any conditions that the Monetary Authority thinks proper to attach to the approval in any particular case.

(5) Without prejudice to the generality of subsection (4), the Monetary Authority may at any time, by notice in writing to a category 2 institution in respect of which he has granted an approval under subsection (3)(a), attach to the institution's approval, with effect from the date, or the occurrence of an event, specified in the notice, any conditions (including attach by amending conditions already attached to the approval), or cancel any conditions attached to the approval, that the Monetary Authority thinks proper.

51. Management of liquefiable assets and related risks by category 2 institution

(1) A category 2 institution must have in place and maintain adequate systems and procedures for the on-going assessment and management of its liquefiable assets in order to ensure that—

(a) each asset included in the liquefiable assets satisfies all the requirements of Part 8 that are applicable to its inclusion in the liquefiable assets;

(b) an asset included in the liquefiable assets which ceases to satisfy one or more requirements of Part 8 applicable to its inclusion in the liquefiable assets is identified as soon as is practicable; and

(c) prompt action is taken to exclude from the liquefiable assets an asset identified as referred to in paragraph (b).

(2) A category 2 institution must have in place and maintain adequate systems to monitor and control the risks, including but not limited to liquidity risk, associated with its holdings in liquefiable assets.

52. General exclusion of assets from liquefiable assets, etc.

(1) The Monetary Authority may, by notice in writing to all category 2 institutions, specify that a category 2 institution must not include in its liquefiable assets, with effect from the date, or the occurrence of an event, specified in the notice, an asset, or a class of assets, of the type specified in the notice, on the ground that the Monetary Authority is satisfied that that type of asset or class of assets, as the case may be—

(a) is not capable of generating liquidity for the institution within one month; or

(b) is not, or is no longer, sufficiently liquid in private markets to be included in any category 2 institution's liquefiable assets.

(2) Every category 2 institution must comply with the requirements of a notice given to it under subsection (1).

53. Specific exclusion of assets from liquefiable assets, etc.

(1) The Monetary Authority may, by notice in writing to a category 2 institution, require the institution, with effect from the date, or the occurrence of an event, specified in the notice—

(a) to cease to include in its liquefiable assets the asset specified in the notice on the ground that the Monetary Authority is satisfied that it no longer satisfies, or has never satisfied, the liquidity requirement rule specified in the notice that is applicable to the inclusion of that asset in its liquefiable assets; or

(b) without prejudice to the generality of subsection (1), to make the changes specified in the notice to its liquefiable assets on the ground that the Monetary Authority is satisfied that those changes are necessary in order to mitigate the liquidity risk associated with the institution's failure, specified in the notice, to comply with section 51.

(2) A category 2 institution must comply with the requirements of a notice given to it under subsection (1).

54. Calculation of net weighted amount of qualifying liabilities (after deductions)

(1) Subject to subsections (2) and (3), a category 2 institution may exclude a pledged deposit from the calculation of its LMR if—

(a) the deposit is pledged as collateral against a loan which will not be settled within one month;

(b) the pledge arrangement concerned is subject to a legally enforceable contract that effectively disallows the withdrawal of the deposit before the loan is fully settled;

(c) the deposit would otherwise be included in the calculation of qualifying liabilities under section 49; and

(d) the amount of deposit to be excluded from the calculation does not exceed the outstanding balance of the loan.

(2) A category 2 institution must not, in the calculation of its net weighted amount of qualifying liabilities under the LMR, deduct a cash inflow from its qualifying liabilities unless the cash inflow—

(a) is expected to be received within one month; and

(b) arises from assets (whether on-balance sheet assets or off-balance sheet assets) that are fully performing and in respect of which the institution has no reason to expect a default within one month.

(3) For the purposes of subsection (2), a category 2 institution must—

(a) assume that a cash inflow is received by the institution at the latest possible date based on contractual rights available to its customers; and

(b) not include any cash inflow that is contingent in nature.

Schedule 1

ss. 4 & 16

Grounds for Designating Authorized Institution as Category 1 Institution and Exceptions to those Grounds

Part 1

Grounds for Designating Authorized Institution as Category 1 Institution (whether or not on Application by Institution)

1. The authorized institution is internationally active.

2. The authorized institution is significant to the general stability and effective working of the banking system in Hong Kong.

3. The liquidity risk associated with the authorized institution is material.

4. The authorized institution is so connected to a category 1 institution that, if the first-mentioned institution were not designated as a category 1 institution under section 4(1), that connection would prejudice, or may potentially prejudice, the calculation under Part 7 or Part 8 of the requirements applicable to either or both institutions.

Part 2

Grounds for Designating Authorized Institution as Category 1 Institution (only on Application by Institution)

1. In the case of an authorized institution that does not fall within any of the grounds specified in Part 1, the institution demonstrates that—

   (a) its particular circumstances provide reasonable justification for it to be designated under section 4(1) as a category 1 institution; and

   (b) it has the capacity (including systems and resources) to comply with all the provisions of these Rules as they apply to category 1 institutions.

Part 3

Exceptions to Grounds specified in Parts 1 and 2 of this Schedule

1. In the case of a ground specified in Part 1, the authorized institution is incorporated outside Hong Kong and demonstrates that—

   (a) it is adequately supervised in respect of liquidity risk by the relevant banking supervisory authority; and

(b) it complies with liquidity regulations in the place outside Hong Kong where it is incorporated that are comparable to the requirements of these Rules that apply to category 1 institutions.

2. In the case of a ground specified in Part 1 or 2, the authorized institution demonstrates that—

(a) its particular circumstances provide reasonable justification for it not to be designated under section 4(1) as a category 1 institution; and

(b) it would not materially prejudice the calculation of its liquidity requirements under these Rules if the institution were not so designated.

Schedule 2

ss. 2, 18, 26 & 36

Classes of Assets which may be included in HQLA for Calculating LCR and Qualifying Criteria applicable to those Classes

Part 1

Classes of Assets which may be included in HQLA for calculating LCR

1. Level 1 assets

The following assets are level 1 assets for the purposes of these Rules—

(a) currency notes and coins;

(b) central bank reserves;

(c) subject to section 1 of Part 2, marketable debt securities that are issued or guaranteed by a sovereign, central bank, public sector entity, relevant international organization or multilateral development bank, or that are EF debt securities;

(d) subject to section 2 of Part 2, marketable debt securities that are issued by the sovereign or central bank of a country and denominated in the local currency of that country, or that are EF debt securities, and which, under the standardized (credit risk) approach—

(i) do not qualify for 0% risk-weight under section 55(2) of the Capital Rules; or

(ii) qualify for 0% risk-weight only by virtue of section 56(1) or (2) of the Capital Rules; and

(e) subject to section 3 of Part 2, marketable debt securities that are issued by the sovereign or central bank of a country and denominated in a currency that is not the local currency of that country and which do not, under the standardized (credit risk) approach, qualify for a 0% risk-weight under section 55(2) of the Capital Rules.

2. Level 2A assets

The following assets are level 2A assets for the purposes of these Rules—

(a) subject to section 4 of Part 2, marketable debt securities that are issued or guaranteed by a sovereign, central bank or public sector entity;

(b) subject to section 5 of Part 2, marketable debt securities issued by corporates; and

(c) subject to section 6 of Part 2, covered bonds.

3. Level 2B assets

The following assets are level 2B assets for the purposes of these Rules—

(a) subject to section 7 of Part 2, marketable debt securities issued by corporates; and

(b) subject to sections 8 and 9 of Part 2, RMBS.

Part 2

Qualifying Criteria applicable to Classes of Assets which may be included in HQLA for calculating LCR

1. Qualifying criteria—section 1(c) of Part 1 marketable debt securities (level 1 assets)

(1) A marketable debt security does not fall within section 1(c) of Part 1 unless—

(a) it qualifies, in the calculation of credit risk under the standardized (credit risk) approach, for 0% risk-weight—

(i) subject to subsections (2) and (3), under section 55(2) of the Capital Rules in any case where the debt security is issued or guaranteed by a sovereign or central bank or is an EF debt security;

(ii) under section 57(2)(b) of the Capital Rules in any case where the debt security is issued or guaranteed by a public sector entity;

(iii) under section 56(4) of the Capital Rules in any case where the debt security is issued or guaranteed by a relevant international organization; and

(iv) under section 58 of the Capital Rules in any case where the debt security is issued or guaranteed by a multilateral development bank;

(b) it is traded in large, deep and active markets, characterized by a low level of concentration, and where debt securities of that type can be monetized through direct sale or repo-style transactions;

(c) it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress; and

(d) it is not an obligation of a financial institution or an associated entity of a financial institution unless the debt security is issued by a bank which is a public sector entity.

(2) Section 56(2) of the Capital Rules must be disregarded for the purposes of calculating credit risk as specified in subsection (1)(a)(i).

(3) For the purposes of subsection (1)(a)(i), an EF debt security must be treated as if it were a marketable debt security issued by a central bank.

2. Qualifying criteria—section 1(d) of Part 1 marketable debt securities (level 1 assets)

(1) A marketable debt security issued by the sovereign or central bank of a country does not fall within section 1(d) of Part 1 unless the category 1 institution holding that debt security is incorporated in that country or carries on a banking business, through a branch or subsidiary, in that country.

(2) To avoid doubt, if a marketable debt security, issued by a sovereign or central bank and with a risk-weight of 20% under the standardized (credit risk) approach, falls within both section 1(d) of Part 1 and section 2(a) of Part 1, it may, at the discretion of the category 1 institution, be treated as falling within section 1(d) of Part 1 only.

(3) For the purposes of this section, an EF debt security must be treated as if it were a marketable debt security issued by a central bank.

3. Qualifying criteria—section 1(e) of Part 1 marketable debt securities (level 1 assets)

(1) A marketable debt security does not fall within section (1)(e) of Part 1 unless—

(a) it is issued by the sovereign or central bank of a country in which the category 1 institution holding the debt security is incorporated or carries on a banking business through a branch or subsidiary; and

(b) the amount of the category 1 institution's holding in the debt security that may be eligible for inclusion in the institution's HQLA does not exceed the amount of total net cash outflows in the currency of the debt security arising from the institution's banking business in the country in which the debt security is issued.

(2) To avoid doubt, if a marketable debt security, issued by a sovereign or central bank and with a risk-weight of 20% under the standardized (credit risk) approach, falls within both section 1(e) of Part 1 and section 2(a) of Part 1, it may, at the discretion of the category 1 institution, be treated as falling within section 1(e) of Part 1.

4. Qualifying criteria—section 2(a) of Part 1 marketable debt securities (level 2A assets)

(1) A marketable debt security does not fall within section 2(a) of Part 1 unless—

(a) it qualifies, in the calculation of credit risk under the standardized (credit risk) approach, for 20% risk-weight—

(i) subject to subsections (2) and (3), under section 55(2) of the Capital Rules in any case where the debt security is issued or guaranteed by a sovereign or central bank; and

(ii) under section 57 of the Capital Rules in any case where the debt security is issued or guaranteed by a public sector entity;

(b) it is traded in large, deep and active markets, characterized by a low level of concentration, and where debt securities of that type can be monetized through direct sale or repo-style transactions;

(c) subject to subsection (4), it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress; and

(d) it is not an obligation of a financial institution or an associated entity of a financial institution, unless the debt security is issued by a bank which is a public sector entity.

(2) Section 56(2) of the Capital Rules must be disregarded for the purposes of calculating credit risk as specified in subsection (1)(a)(i).

(3) A marketable debt security, to meet the criterion specified in subsection (1)(c), must not have experienced a decline of more than 10% of its market price, or an increase in haircut of more than 10 percentage points if it is used as collateral in a repo-style transaction, within any period of 30 calendar days since the debt security was issued.

5. Qualifying criteria—section 2(b) of Part 1 marketable debt securities (level 2A assets)

(1) A marketable debt security does not fall within section 2(b) of Part 1 unless—

(a) subject to subsection (2), if the debt security is issued by a corporate incorporated outside India, it has an ECAI issue specific rating that, if mapped to the scale of credit quality grades in Part 1 of Table C (in the case of a long-term ECAI issue specific rating) or Part 1 of Table E (in the case of a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security being assigned a credit quality grade of 1;

(b) subject to subsection (2), if the debt security is issued by a corporate incorporated in India, it has an ECAI issue specific rating that, if mapped to the scale of credit quality grades in Table C (in the case of a long-term ECAI issue specific rating) or Table E (in the case of a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security being assigned a credit quality grade of 1;

(c) if the debt security does not have an ECAI issue specific rating and the category 1 institution holding the debt security has the Monetary Authority's approval to use

the IRB approach under section 8 of the Capital Rules (or, if the institution is incorporated outside Hong Kong, it has the approval of the relevant banking supervisory authority to use an internal ratings-based approach that reflects the standards of the Basel Committee for calculation of its regulatory capital for credit risk), it is internally rated by that institution as having a probability of default corresponding to the credit quality grade required under paragraph (a) or (b);

(d) it is traded in large, deep and active markets, characterized by a low level of concentration, and where debt securities of that type can be monetized through direct sale or repo-style transactions;

(e) subject to subsection (3), it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress;

(f) it is not issued by a financial institution or any of its associated entities; and

(g) it is not a structured financial instrument or subordinated debt.

(2) If a marketable debt security has more than one ECAI issue specific rating, the category 1 institution holding the debt security must, for the purposes of subsection (1)(a) and (b), apply section 69(2) of the Capital Rules to determine the ECAI issue specific rating of the debt security.

(3) A marketable debt security, to meet the criterion specified in subsection (1)(e), must not have experienced a decline of more than 10% of its market price, or an increase in haircut of more than 10 percentage points if it is used as collateral in a repo-style transaction, within any period of 30 calendar days since the debt security was issued.

6. Qualifying criteria—section 2(c) of Part 1 covered bonds (level 2A assets)

(1) A covered bond does not fall within section 2(c) of Part 1 unless—

(a) it is issued by a person other than the category 1 institution holding the covered bond or any of the institution's associated entities;

(b) subject to subsection (2), it has an ECAI issue specific rating that, if mapped to the scale of credit quality grades in Table B (in the case of a long-term ECAI issue specific rating) or Part 1 of Table E (in the case of a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the covered bond being assigned a credit quality grade of 1;

(c) if the covered bond does not have an ECAI issue specific rating and the category 1 institution holding the covered bond has the Monetary Authority's approval to use the IRB approach under section 8 of the Capital Rules (or, if the institution is incorporated outside Hong Kong, it has the approval of the relevant banking supervisory authority to use an internal ratings-based approach for calculation of its regulatory capital), it is internally rated by that institution as having a probability of default corresponding to the credit quality grade required under paragraph (b);

(d) it is traded in large, deep and active markets, characterized by a low level of concentration, and where covered bonds of that type can be monetized through direct sale or repo-style transactions; and

(e) subject to subsection (3), it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress.

(2) If a covered bond has more than one ECAI issue specific rating, the category 1 institution holding the covered bond must, for the purposes of subsection (1)(b), apply section 69(2) of the Capital Rules to determine the ECAI issue specific rating of the covered bond.

(3) A covered bond, to meet the criterion specified in subsection (1)(e), must not have experienced a decline of more than 10% of its market price, or an increase in haircut of more than 10 percentage points if it is used as collateral in a repo-style transaction, within any period of 30 calendar days since the covered bond was issued.

7. Qualifying criteria—section 3(a) of Part 1 marketable debt securities (level 2B assets)

(1) A marketable debt security does not fall within section 3(a) of Part 1 unless—

(a) subject to subsection (2), if the debt security is issued by a corporate incorporated outside India, it has an ECAI issue specific rating that, if mapped to the scale of credit quality grades in Part 1 of Table C (in the case of a long-term ECAI issue specific rating) or Part 1 of Table E (in the case of a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security being assigned a credit quality grade of 2;

(b) subject to subsection (2), if the debt security is issued by a corporate incorporated in India, it has an ECAI issue specific rating that—

(i) if mapped to the scale of credit quality grades in Part 1 of Table C (in the case of a long-term ECAI issue specific rating) or Part 1 of Table E (in the case of a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security being assigned a credit quality grade of 2; and

(ii) if mapped to the scale of credit quality grades in Part 2 of Table C (in the case of a long-term ECAI issue specific rating) or Part 2 of Table E (in the case of a short-term ECAI issue specific rating) in Schedule 6 to the Capital Rules, would result in the debt security being assigned a credit quality grade of 2 or 3;

(c) if the debt security does not have an ECAI issue specific rating and the category 1 institution holding the debt security has the Monetary Authority's approval to use the IRB approach under section 8 of the Capital Rules (or, if the institution is incorporated outside Hong Kong, it has the approval of the relevant banking supervisory authority to use an internal ratings-based approach for calculation of its regulatory capital), it is internally rated by that institution as having a probability of default corresponding to the credit quality grade required under paragraph (a) or (b);

(d) it is traded in large, deep and active markets, characterized by a low level of concentration, and where debt securities of that type can be monetized through direct sale or repo-style transactions;

(e) subject to subsection (3), it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress;

(f) it is not issued by a financial institution or any of its associated entities; and

(g) it is not a structured financial instrument or subordinated debt.

(2) If a marketable debt security has more than one ECAI issue specific rating, the category 1 institution holding the debt security must, for the purposes of subsection (1)(a) and (b), apply section 69(2) of the Capital Rules to determine the ECAI issue specific rating of the debt security.

(3) A marketable debt security, to meet the criterion specified in subsection (1)(e), must not have experienced a decline of more than 20% of its market price, or an increase in haircut of more than 20 percentage points if it is used as collateral in a repo-style transaction, within any period of 30 calendar days since the debt security was issued.

8. Qualifying criteria—section 3(b) of Part 1 RMBS (level 2B assets)

(1) An RMBS does not fall within section 3(b) of Part 1 unless—

(a) it has the prior approval of the Monetary Authority under section 9;

(b) it is issued, and its underlying assets are originated, by a person other than the category 1 institution holding the RMBS or any of the institution's associated entities;

(c) subject to subsection (2), if the RMBS is issued by a public sector entity, financial institution or corporate incorporated outside India, it has a long-term ECAI issue specific rating that, if mapped to a scale of credit quality grades in Table B or Part 1 of Table C, as the case requires, in Schedule 6 to the Capital Rules, would result in the RMBS being assigned a credit quality grade of 1;

(d) subject to paragraph (e) and subsection (2), if the RMBS is issued by a public sector entity, financial institution or corporate incorporated in India, it has a long-term ECAI issue specific rating that, if mapped to a scale of credit quality grades in Table B or Table C, as the case requires, in Schedule 6 to the Capital Rules, would result in the RMBS being assigned a credit quality grade of 1;

(e) it does not have any of the following ECAI issue specific ratings in the case of Table B or Part 1 of Table C, as the case requires, in Schedule 6 to the Capital Rules—

(i) Standard & Poor's Ratings Service AA-;

(ii) Moody's Investors Service Aa3;

(iii) Fitch Ratings AA-;

(iv) Rating and Investment Information, Inc. AA-; and

(v) Japan Credit Rating Agency, Ltd. AA-;

(f) it is traded in large, deep and active markets, characterized by a low level of concentration, and where RMBS of that type can be monetized through direct sale or repo-style transactions;

(g) subject to subsection (3), it has a proven record as a reliable source of liquidity in those markets, even during a period of financial stress;

(h) it is backed by a pool of residential mortgage loans that have full recourse to the mortgagor and the weighted average loan-to-value ratio of which does not exceed 80% at the time when the RMBS is issued; and

(i) it is subject to regulations which require issuers of the RMBS to retain an interest in the RMBS.

(2) If an RMBS has more than one ECAI issue specific rating, the category 1 institution holding the RMBS must, for the purposes of subsection (1)(c) and (d), apply section 69(2) of the Capital Rules to determine the ECAI issue specific rating of the RMBS.

(3) An RMBS, to meet the criterion specified in subsection (1)(g) must not have experienced a decline of more than 20% of its market price, or an increase in haircut of more than 20 percentage points if it is used as collateral in a repo-style transaction, within any period of 30 calendar days since the RMBS was issued.

(4) To avoid doubt, the underlying assets of the RMBS must not contain any structured financial instrument.

9. Category 1 institution requires Monetary Authority's prior approval to include RMBS in its HQLA

(1) The Monetary Authority may, by notice in writing to a category 1 institution that has made an application to the Monetary Authority for the grant of an approval under this subsection, determine the application by—

(a) granting approval to the institution, with effect from the date, or the occurrence of an event, specified in the notice, to include the RMBS specified in the notice in its HQLA if the institution demonstrates to the satisfaction of the Monetary Authority that—

(i) that RMBS meets the requirements of section 8 applicable to it; and

(ii) the institution has in place and maintains adequate systems and measures to monitor and control the risks associated with holding that RMBS; or

(b) if the Monetary Authority is not satisfied as referred to in paragraph (a), refusing to grant the approval and specifying in the notice the reasons why the Monetary Authority is not so satisfied.

(2) If the Monetary Authority grants an approval under subsection (1)(a) to a category 1 institution, the approval may be granted subject to any conditions that the Monetary Authority thinks proper to attach to the approval in any particular case.

(3) Without prejudice to the generality of subsection (2), the Monetary Authority may at any time, by notice in writing to a category 1 institution in respect of which he has granted an approval under subsection (1)(a), attach to the institution's approval, with effect from the date, or the occurrence of an event, specified in the notice, any conditions (including attach by amending conditions already attached to the approval), or cancel any conditions attached to the approval, that the Monetary Authority thinks proper.

Schedule 3

ss. 18 & 26

Characteristic requirements that Asset must Satisfy before it can be included in HQLA for purposes of Calculation of LCR

1. Principal characteristic

Subject to section 2, the asset must at all times be easily and immediately monetizable with little or no loss of value.

2. General characteristics

The asset does not fall within section 1 unless it has the following characteristics—

(a) the risks (including any risk of default) that are associated with the asset are so low that they do not prejudice the asset's ability to be monetizable as specified in section 1;

(b) the value of the asset is readily identifiable and measurable, and can be readily agreed upon by the parties to a transaction involving the asset, by reference to—

(i) the asset's book value;

(ii) the asset's current market price; or

(iii) a simple valuation method or pricing formula based on publicly available market data;

(c) if the asset is a structured financial instrument, the structure of the instrument is simple and standardized;

(d) the asset does not—

(i) have a strong correlation with another asset that has a material risk; and

(ii) significantly expose the holder of the asset to specific wrong-way risk or general wrong-way risk;

(e) if the asset is traded in a secondary market—

(i) the market is active and sizable having regard to—

(A) the diversity and large number of participants in the market;

(B) the presence of committed market-makers; and

(C) the high volumes and low pricing spreads traded in the market;

(ii) the asset is able to be readily monetized without a substantial discount or haircut to its market price; and

(iii) the historical volatility associated with the trading prices and spreads of the asset are low;

(f) if the asset is listed on an exchange, the exchange is a recognized exchange; and

(g) the asset is denominated in Hong Kong dollars or a convertible currency.

Schedule 4

ss. 18, 26 & 27

Operational requirements that Category 1 Institution and Asset must Satisfy before Asset can be included in HQLA for purposes of Calculation of LCR

1. Operational requirements

(1) The category 1 institution must have in place and maintain adequate operational capacity and systems to readily monetize any asset in its HQLA without being constrained by its internal business or risk management strategy.

(2) The category 1 institution's HQLA must be—

(a) managed by a liquidity management function designated by the institution for the purpose (**designated function**) which has the continuous authority and legal and operational capability to monetize any asset included in the institution's HQLA; and

(b) subject to subsection (3), maintained in a separate pool of assets under the control of the designated function with the sole intent of being used as a source of contingency funding.

(3) The category 1 institution does not need to satisfy subsection (2)(b) if it demonstrates to the satisfaction of the Monetary Authority that—

(a) the designated function can monetize any asset in the institution's HQLA at any time within a period of financial stress that lasts for 30 calendar days; and

(b) the proceeds of monetizing any asset in the institution's HQLA are available to the designated function throughout 30 calendar days without direct conflict with the institution's internal business or risk management strategy.

(4) The category 1 institution periodically monetizes a representative portion of its HQLA to test or verify its ability to access relevant markets for monetizing assets included in its HQLA in case of need.

(5) Subject to section 2(2), any asset in the category 1 institution's HQLA is free from encumbrances and, in particular, there must be no legal, regulatory contractual or other restrictions that inhibit the institution from liquidating, selling, transferring or assigning any asset in its HQLA.

(6) The category 1 institution has in place and maintains adequate policies and monitoring systems to enable it to have full knowledge of the composition of its HQLA, at least on a daily basis, including the legal entity, location, and custodial or other account in which the assets in its HQLA are held and the currencies in which the assets are denominated.

(7) Subject to section 2(2)(e), the asset is freely transferable and available to the category 1 institution, whether between its Hong Kong office and any of its overseas branches and specified associated entities, and is not subject to any liquidity transfer restriction.

(8) If the asset is included in the category 1 institution's HQLA and is likely to be monetized through direct sale, there are no impediments to the sale of the asset and there are no requirements to hold such assets, including, but not limited to, statutory minimum inventory requirements if the institution is a market maker for assets of that type.

2. Provisions supplementary to section 1

(1) In section 1(1), the reference to the category 1 institution having operational capacity means the institution has in place and maintains adequate systems and procedures,

including the designated function referred to in section 1(2)(a), with access to all necessary information for monetizing an asset in its HQLA within the standard settlement period for the type of asset concerned in the jurisdiction concerned.

(2) To avoid doubt, it is declared that—

(a) an asset is not free from encumbrances if—

(i) subject to paragraph (c), the asset is pledged by the category 1 institution, either explicitly or implicitly, to secure, collateralize or provide credit enhancement to a transaction; or

(ii) the asset is designated by the category 1 institution to cover specific expenses;

(b) if an asset meets all the other requirements of these Rules for inclusion in the institution's HQLA but is pledged to the institution in a securities financing transaction, the asset may only be included in the institution's HQLA if—

(i) the institution has a contractual right to re-hypothecate the asset, but the asset has not been re-hypothecated and is legally and contractually available for use by the institution to obtain liquidity within 30 calendar days; and

(ii) the institution has no obligation to return the asset to a third party upon demand or at any time within 30 calendar days;

(c) subject to paragraph (d), if an asset of the category 1 institution meets all the other requirements of these Rules for inclusion in the institution's HQLA but is pre-positioned or deposited with, or pledged to, the Monetary Authority for the account of the Exchange Fund, a central bank or public sector entity for obtaining liquidity facilities, the asset may only be included in the institution's HQLA to the extent that the institution has not utilized the asset to draw on those facilities;

(d) if the category 1 institution has pre-positioned or deposited with, or pledged to, the Monetary Authority for the account of the Exchange Fund, a central bank or public sector entity a pool of assets consisting of level 1 assets, level 2A assets, level 2B assets and other assets that do not qualify as HQLA, and no specific asset in the pool has been designated as collateral for any of the institution's liquidity facilities received from the Monetary Authority for the account of the Exchange Fund, central bank or public sector entity, as the case may be, the institution may, in determining which assets in the pool will be encumbered as it draws upon the facilities, adopt the following order—

(i) first order of encumbrance: assets that do not qualify as HQLA;

(ii) second order of encumbrance: level 2B assets that are not approved RMBS;

(iii) third order of encumbrance: approved RMBS;

(iv) fourth order of encumbrance: level 2A assets; and

(v) fifth order of encumbrance: level 1 assets.

(e) for the purposes of section 1(7), if the asset is held by the category 1 institution in a legal entity that does not have access to relevant markets for monetizing the asset, the asset is not freely transferable unless the asset can be freely transferred to the institution (or to a specified associated entity of the institution that can monetize the asset); and

(f) for the purposes of section 1(2) to (8), if the category 1 institution hedges the market risk of an asset included in its HQLA, it takes into account the cash flows that may arise from the hedging arrangement (including any early closure of the hedge when the asset is sold) in the calculation of its LCR.

Schedule 5

ss. 44, 49 & 50

Liquidity Conversion Factors Applicable to Assets and Liabilities in Calculation of LMR

Table A1

Item no.	Liquefiable Assets	Liquidity conversion factor
1.	Currency notes and coins	100%
2.	Gold bullion.	90%
3.	Claims on, or reserves maintained with, the Monetary Authority for the account of the Exchange Fund and central banks that can be withdrawn overnight or repayable on demand.	100%
4.	The amount, if any, by which the total one-month liabilities of the category 2 institution to banks are exceeded by the total one-month liabilities of banks to the institution (***net due from banks***), but the weighted amount of ***net due from banks*** of the institution to be included in its liquefiable assets referred to in section 49(3) of these Rules must not exceed 40% of the total weighted amount of its qualifying liabilities referred to in section 49(4) of these Rules (that is, before any deductions) (***40% ceiling***).	80%
5.	Export bills— (a) payable within 1 month and which are either drawn under letters of credit issued by banks or accepted and payable by banks; or (b) covered by irrevocable re-discounting facilities approved by the Monetary Authority.	 90% 90%
6.	Marketable debt securities or prescribed instruments— (a) issued or guaranteed by— (i) the Government, the Monetary Authority for the account of the Exchange Fund, or a domestic public sector entity, with a remaining term to maturity of— (A) not more than 1 year; (B) more than 1 year; (ii) an authorized institution incorporated in Hong Kong or the Hong Kong branch of an authorized institution incorporated outside Hong Kong with a remaining term to maturity of— (A) not more than 1 month; (B) more than 1 month but not more than 1 year; (C) more than 1 year; (b) issued or guaranteed by the central bank or central government of any country, a multilateral development bank, or a relevant international organization, where the debt security or instrument, or its issuer or guarantor, has a	 100% 95% 100% 95% 90%

Item no.	Liquefiable Assets	Liquidity conversion factor
	qualifying ECAI rating, with a remaining term to maturity of—	
	(i) not more than 1 year;	100%
	(ii) more than 1 year;	95%
	(c) with a qualifying ECAI issue specific rating, issued or guaranteed by—	
	(i) a bank, other than those included in item no. 6(a)(ii), with a remaining term to maturity of—	
	(A) not more than 1 month;	100%
	(B) more than 1 month but not more than 1 year;	95%
	(C) more than 1 year;	90%
	(ii) a regional government of any country or other entity with a remaining term to maturity of—	
	(A) not more than 1 year;	90%
	(B) more than 1 year but not more than 5 years;	85%
	(C) more than 5 years;	80%
	(d) without a qualifying ECAI issue specific rating, issued or guaranteed by—	
	(i) a bank, other than those included in item 6(a)(ii), provided that—	
	(A) the debt security or instrument has a remaining term to maturity of not more than 1 month; or	100%
	(B) the bank has a qualifying ECAI issuer rating;	80%
	(ii) a regional government of a country which has a qualifying ECAI issuer rating;	80%
	(e) not included elsewhere in item no. (A6), re-discountable with the Monetary Authority for the account of the Exchange Fund or the central bank of a country that has a qualifying ECAI issuer rating, and the re-discounting arrangement is available to the category 2 institution;	80%
	(f) RMBS or other debt securities or instruments specifically approved for inclusion by the Monetary Authority;	80%
	(g) not included elsewhere in item no. 6 with a remaining term to maturity of not more than 1 month.	80%
7.	Residential mortgage loans in respect of which there has been issued by The Hong Kong Mortgage Corporation Limited an irrevocable commitment to purchase which is approved by the Monetary Authority.	90%

Table A2

Item no.	Deduction from Liquefiable Assets	Liquidity conversion factor
1.	Debt securities or prescribed instruments with a remaining term to maturity of not more than 1 month issued by the category 2 institution (other than any debt security or prescribed instrument that the Monetary Authority has approved may be excluded from inclusion in this table where the category 2 institution concerned has demonstrated to the satisfaction of the Monetary Authority that the treatment to be accorded to the debt security or instrument for the purpose of the calculation of qualifying liabilities is appropriate).	100%

Table B

Item no.	Qualifying Liabilities	Liquidity conversion factor
1.	Total one-month liabilities of the category 2 institution to the Monetary Authority for the account of the Exchange Fund and central banks.	100%
2.	If the category 2 institution's total one-month liabilities to banks exceed the total one-month liabilities of banks to the institution, the amount of its total one-month liabilities to banks.	100%
3.	Other one-month liabilities.	100%

Table C

Item no.	Deduction from Qualifying Liabilities	Liquidity conversion factor
1.	One-month liabilities of the Monetary Authority for the account of the Exchange Fund and central banks to the category 2 institution (other than the amount included in item no.3 of Table A1).	100%
2.	If the category 2 institution's total one-month liabilities to banks exceed the total one-month liabilities of banks to the institution, the amount of the total one-month liabilities of banks to it.	100%
3.	The amount, if any, by which the 40% ceiling specified in item no. 4 of Table A1 is exceeded by the weighted amount of the category 2 institution's ***net due from banks*** calculated under that item.	100%
4.	Eligible loan repayments.	80%

Explanatory Note

These Rules are made by the Monetary Authority under section 97H of the Banking Ordinance (Cap. 155), as amended by section 8 of the Banking (Amendment) Ordinance 2012 (No. 3 of 2012).

2. The main purpose of the Rules is to—

   (a) give effect, in Hong Kong, to the requirements of the document entitled "Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools" published by the Basel Committee on Banking Supervision in January 2013; and

   (b) replace and revise the requirements presently set out in section 102 of, and the Fourth Schedule to, the Banking Ordinance.

3. The requirements referred to in paragraph 2(a) above will only apply to authorized institutions that are designated by the Monetary Authority under section 4(1) of the Rules as category 1 institutions on one or more of the grounds specified in Part 1 or 2 of Schedule 1 to the Rules. Those grounds include, *among others*, that the authorized institution is internationally active or significant to the general stability and effective working of the banking system of Hong Kong or that the liquidity risk associated with the authorized institution is material.

4. The principal requirement placed on a category 1 institution is that it must at all times maintain a liquidity coverage ratio (see the definitions of ***liquidity coverage ratio*** and ***LCR*** in section 2(1) of the Rules) of not less than 100% on and after 1 January 2019 with staged increments through 2015 to 2018 leading up to that 100% (see section 5 of the Rules). Section 6 of the Rules requires a category 1 institution to notify the Monetary Authority of any matter which will or may cause it to maintain a liquidity coverage ratio less than as required under section 5 of the Rules. Section 7 of the Rules sets out the circumstances in which a category 1 institution may monetize its high quality liquid assets included in the calculation of its LCR to meet its obligations, even if this might cause the institution to maintain an LCR less than as required under section 5 of the Rules.

5. Part 7 of the Rules, as read with Schedules 1 to 4 to the Rules, sets out the technical requirements relating to the calculation by a category 1 institution of its LCR.

6. All authorized institutions that are not designated by the Monetary Authority as category 1 institutions are automatically category 2 institutions (see the definition of category 2 institutions provided in section 2(1)) and subject to the revised requirements referred to in paragraph 2(b) above.

7. The principal requirement placed on a category 2 institution is that it must maintain a liquidity maintenance ratio (see the definitions of ***liquidity maintenance ratio*** and ***LMR*** in section 2(1) of the Rules) of not less than 25% on average in each calendar month (see section 8 of the Rules). Section 9 of the Rules requires a category 2 institution to notify the Monetary Authority of any matter which will or may cause it to maintain an LMR less than as required under section 8.

8. Part 8 of the Rules, as read with Schedule 5 to the Rules, sets out the technical requirements relating to the calculation by a category 2 institution of its LMR.

9. Part 4 of the Rules sets out requirements relating to the valuation of assets that are applicable to category 1 and category 2 institutions in calculating LCR or LMR. Part 5 sets out certain reporting requirements. Part 6 sets out the actions that the Monetary Authority may take when notified of certain relevant liquidity events within the meaning of section 15 of the Rules.

10. The Rules come into operation on 1 January 2015 (see section 1 of the Rules).