HONG KONG MONETARY AUTHORITY
香港金融管理局

Banking Policy Department

Our Ref.: B1/15C
S4/3C

17 December 2014

The Chief Executive
All locally incorporated Authorized Institutions

Dear Sir/Madam,

Basel Capital Framework - Revisions to the Securitisation Framework

As you may be aware, the Basel Committee on Banking Supervision (BCBS) issued its final paper on *Revisions to the securitisation framework*[1] on 11 December 2014.

Forming part of the BCBS regulatory reform under Basel III, the revisions aim to address weaknesses in the Basel II securitisation framework by reducing mechanistic reliance on external ratings, recalibrating risk weights for highly-rated and low-rated securitisation exposures, reducing cliff effects and enhancing risk sensitivity of the framework. Scheduled to take effect in January 2018, the revised framework will apply to securitisation exposures held in the banking book. The revised framework for securitisation exposures held in the trading book is currently under review by the BCBS.

The most significant revisions are made in respect of the following areas–

(A) Hierarchy of approaches

At the top of the revised hierarchy is the Internal Ratings-Based Approach, which may be used by banks that have obtained supervisory approval for the use of internal models for credit risk. Next in the hierarchy are the External Ratings-Based Approach (where capital charges are determined based on external credit ratings and additional risk drivers) and the Standardised Approach (where capital charges are calculated by using a supervisory formula).

The application of an approach within the revised hierarchy depends on the information that is available to the bank concerned and on the type of analysis and estimations it can perform for a specific transaction. Where none of the

[1] See http://www.bis.org/bcbs/publ/d303.pdf

three approaches within the hierarchy can be applied to a securitisation exposure, the bank is required to risk-weight the exposure at 1,250%.

(B) Risk drivers used in each approach

Additional risk drivers, including notably an explicit adjustment to take account of the maturity of a securitisation's tranche, have been introduced to address the issue of under-capitalisation of certain exposures under the Basel II framework.

(C) The calibration of the framework

The capital requirements have been significantly increased, commensurate with the risk of securitisation exposures. However, risk-weights as low as 15% may still be assigned to senior securitisation exposures backed by good quality pools. Moreover, maximum risk-weights for senior tranches and maximum capital requirements for securitisation exposures are introduced to promote consistency of the revised securitisation framework with the IRB framework for non-securitisation exposures and to avoid disincentivising securitisations of low credit risk exposures.

The HKMA intends to implement the revised framework in accordance with the BCBS timetable and will consult the industry on its implementation proposals for Hong Kong in due course. In the meantime, authorized institutions are strongly recommended to familiarise themselves with the revised framework and to carefully consider the implications on their business activities.

Should you have any questions on the revised securitisation framework, please feel free to contact Mr Andy Cheung at 2878-1022 (in the case of institutions currently using the Internal Ratings-Based (Securitization) Approach) or Miss Samantha Yau at 2878-8284 (in the case of institutions currently using the Standardized (Securitization) Approach).

Yours faithfully,

Richard Chu
Acting Executive Director (Banking Policy)

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