Completion Instructions

Return of Large Exposures
Form MA(BS)1D

Introduction

1. This Return collects information on authorized institutions' ("AIs") large exposures to banks, non-bank entities and connected parties.

2. These Completion Instructions contain two sections. Section A gives instructions on the general reporting requirements. Section B explains the reporting requirements for each individual item in the Return form.

Section A : General Instructions

3. The basis of reporting and submission deadline applicable to AIs incorporated in and outside Hong Kong are as follows: -

	Basis of reporting	Submission deadline
AIs incorporated in Hong Kong	One Return on the combined position of the Hong Kong offices and all overseas branches (if any)	Not later than 6 weeks after the end of each quarter
	One Return on the consolidated position (Note)	Not later than 6 weeks after the end of each quarter
AIs incorporated outside Hong Kong	One Return on the position of the Hong Kong offices only	Not later than 6 weeks after the end of each quarter

If the submission deadline falls on a public holiday, it will be deferred to the next working day.

Note: Unless otherwise specified by the Monetary Authority ("MA"), the subsidiaries to be included for reporting in this Return should be the same as those included for calculating the reporting institution's consolidated position under Section 81 of the Banking Ordinance ("BO"). The MA may, by notice in writing, require the institution to include also the exposures of its holding companies or any of the subsidiaries of such holding companies in this Return.

4. Inter-branch transactions are not required to be reported under this Return.

Definitions

5. For the purposes of this Return:

(i) "A group of related counterparties" means parties which are connected in such a way that the financial soundness of any of them may affect the financial soundness of the others, e.g.

(a) companies which are subsidiaries of the same holding company or which have the same controller;

(b) the holding company and its subsidiaries; and

(c) counterparties linked by cross guarantees or whose liabilities are guaranteed by the same guarantor.

For the purposes of this Return, the central and local governments of a country should be regarded as a group of related counterparties. Other enterprises and agencies established or owned by the central government or any of the local governments should however be regarded as separate entities. If the exposures to the enterprises or agencies in question are guaranteed by the central government or any of the local governments, they should be reported as guaranteed exposures as illustrated in paragraph 15 of this Section.

To avoid doubt, the Exchange Fund should be regarded as part of the Hong Kong Government. Market Makers of Exchange Fund Bills/Notes and other Specified Instruments should report their aggregate long positions in each issue of these instruments as exposures to the Government or the other issuers, as the case may be.

(ii) "Banks" mean –

(a) institutions authorized under the BO, and institutions which are regarded as banks by the appropriate supervisory authorities in their place of incorporation. (Also covered in this definition are banks connected to the reporting institution); and

(b) central banks.

(iii) "Capital base" of a locally incorporated reporting institution is as defined under section 36 of the Banking (Capital) Rules ("BCR"). Reporting institutions incorporated in overseas countries which have adopted the Basel capital framework should use the capital base of their head offices. Other overseas incorporated reporting institutions may use the capital and reserves (excluding provisions however described) of their head offices in place of capital base. For the purposes of this Return, reporting institutions should use the latest capital base figures for reporting: locally incorporated institutions should use the figures as at the end of the previous quarter and overseas incorporated institutions should use the latest figures obtained from their head offices.

(iv) "Commitments and contingencies" refer to the off-balance sheet items specified in the Specification of Factors (Financial Exposure of Authorized Institution) Notice 2007[1], including:

[1] Chapter 155P of the laws of Hong Kong.

- Direct credit substitutes;
- Transaction-related contingencies;
- Trade-related contingencies;
- Asset sales with recourse;
- Forward asset purchases;
- Partly paid-up shares and securities;
- Forward forward deposits placed;
- Note issuance and revolving underwriting facilities; and
- Any other commitments such as undrawn credit facilities.

However, such items do not include credit facilities which have not been formally advised to the customers concerned. Nevertheless, it should be noted that a credit facility that has been formally advised by a reporting institution to a customer becomes the institution's commitment only when the facility takes effect (not when the customer concerned is advised of the facility).

(v) "Connected parties" refer to counterparties connected to a reporting institution. These include:

(a) intra-group companies, including holding, subsidiary and associated companies of the reporting institution, and other subsidiary and associated companies of the holding company of the institution;

(b) the reporting institution's directors, controllers, minority shareholder controllers, and any "relative" of these directors, controllers and minority shareholder controllers;

(c) the reporting institution's employees who are responsible for approving loan applications and any "relative" of these employees;

(d) any firm or company in which the reporting institution or any of its controllers, minority shareholder controllers or directors or any "relative" of any of its controllers, minority shareholder controllers or directors is interested as director, partner, manager or agent;

(e) any firm or company of which any of the reporting institution's controllers, minority shareholder controllers or directors or any "relative" of any of its controllers, minority shareholder controllers or directors is a guarantor; and

(f) any firm or company which a person specified in (b) and (c) is able to control.

The term "relative" is defined in Section 79 of the BO.

(vi) "Credit default swap" means a credit derivative contract under which the protection buyer pays a fee to the protection seller in return for a payment by the protection seller in the event of a default (or similar credit event) by a reference entity.

(vii) "Credit derivative contract" means a forward contract, swap contract, option contract or similar derivative contract entered into by two parties with the intention to transfer credit risk in relation to a reference obligation from one party (protection buyer) to the other party (protection seller), and generally refers to a credit default swap, total return swap or credit-linked note.

(viii) "Credit-linked note" means a form of structured note with an embedded credit default swap which allows the issuer of the note (protection buyer) to transfer credit risk to the buyer of the note (protection seller).

(ix) "Current exposure", in relation to an OTC derivative transaction or credit derivative contract, means the replacement cost or mark-to-market value of the transaction or contract. Where the replacement cost or mark-to-market value is negative, the current exposure should be taken as zero.

(x) "Current exposure method" means the method referred to in section 2(1) of the BCR for calculating the credit equivalent amount of an off-balance sheet exposure to a counterparty under an OTC derivative transaction or credit derivative contract. For the purposes of this Return, this method is as described under paragraphs 8 and 9 of this Section.

(xi) "Default risk exposure", in relation to an OTC derivative transaction or credit derivative contract, means the exposure to the default risk of the counterparty of the transaction or contract.

(xii) "Derivative exposures" refer to the default risk exposures of a reporting institution arising from the OTC derivative transactions and credit derivative contracts entered into by the institution.

(xiii) "Direct exposures" refer to any exposures to a counterparty who is liable to a reporting institution as principal debtor.

(xiv) "Excluded exchange rate contract" has the meaning as specified in Table 11 of the BCR.

(xv) "Exposures", in relation to a counterparty of a reporting institution, mean all potential losses which might result should the counterparty default. Generally, exposures -

(a) can be in the form of on-balance sheet claims or off-balance sheet contingencies or commitments;
(b) may include assets, such as equities, which do not represent a claim on the counterparty but whose value otherwise depends on that counterparty's financial soundness; and
(c) include those arising from OTC derivative transactions or credit derivative contracts.

For the purposes of this Return, accrued interest, if any, on an exposure should also be reported. However, any accrued interest which has not been recognised in the profit & loss account of the institution but credited as interest in suspense should be netted off against the corresponding amount of accrued interest whether or not it has been capitalised.

(xvi) "Internal approach", in relation to an overseas incorporated reporting institution, refers to the risk measurement approach adopted by the institution locally in respect of its derivative exposures, based on the corresponding approach adopted by its head office or banking group for capital adequacy or large exposure purposes.

(xvii) "Indirect exposures" refer to any exposures to a counterparty of a reporting institution who is liable to the institution as a guarantor. Any indirect exposures should be categorised under Part I, II or III of this Return, where applicable, as "On-balance sheet exposures (excluding those arising from OTC derivative transactions and credit derivative contracts)" (column (2)), "Off-balance sheet exposures arising from commitments and contingencies" (column (3)) or "Default risk exposures arising from OTC derivative transactions and credit derivative contracts" (column (4)) in the same way as the relevant direct exposures recorded by the institution.[2]

(xviii) "Non-bank entities" refer to parties other than banks (including authorized institutions). These parties include international organizations, central and local governments, and any other state-owned enterprises (except state-owned banks) and agencies.

(xix) "OTC derivative transaction" has the meaning assigned to it by section 2(1) of the BCR.

(xx) "Qualifying reference obligation" has the meaning assigned to it by section 51(1) of the BCR.

(xxi) "Potential exposure" means a component of the default risk exposure to the counterparty of an OTC derivative transaction or credit derivative contract entered into by a reporting institution, as calculated in accordance with paragraph 8(ii) or 9(ii) of this Section respectively.

(xxii) "Security" refers to tangible assets (e.g. cash deposits, interest in land and buildings, and interest in the share capital of a company) held by a reporting institution as security. It also refers to guarantees given by a bank or a central government/bank.

(xxiii) "Total return swap" means a credit derivative contract under which the protection buyer –

(a) agrees to pay the protection seller all cash flows which arise from a reference obligation together with any appreciation in the market value of the reference obligation; and

(b) receives, in return for that agreement, a spread over a specified index together with any depreciation in the value of the reference obligation during the term of the contract.

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[2] For example, if there is a guarantor liable to a reporting institution in respect of its default risk exposure arising from an OTC derivative transaction, the institution should report its exposure to the guarantor separately in the same way as the relevant direct exposure recorded by it (i.e. under "Default risk exposures arising from OTC derivative transactions and credit derivative contracts in column (4) of Part I, II or III of this Return).

Determination of exposure values

6. Report the full value of all exposures except derivative exposures. Unless provided otherwise in paragraph 10 of this Section, report the credit equivalent amount of such derivative exposures as calculated in accordance with paragraph 8 or 9 of this Section, as the case requires.

7. Exposures of a reporting institution should be reported before provisions but after netting off the accrued interest against the corresponding interest in suspense as mentioned in paragraph 5(xv) of this Section. Each reported item should be the aggregate of exposures to an individual counterparty or a group of related counterparties. In the latter case, the aggregate should be reported as one exposure showing the name(s) of the principal counterparty(ies).

8. Exposures to counterparties of OTC derivative transactions entered into by a reporting institution should all be regarded as default risk exposures. Subject to the exceptions to the calculation method mentioned below, the credit equivalent amount of a default risk exposure arising from an OTC derivative transaction should be calculated as the sum of -

(i) the current exposure of the transaction; and
(ii) the potential exposure of the transaction, calculated by multiplying the notional principal amount of the transaction by the applicable credit conversion factor set out in the table below.

Residual Maturity	Exchange rate & gold contracts	Interest Rate contracts	Equity contracts	Precious metal contracts (except gold contracts)	Debt security or other commodity contracts
One year or less	1%	0%	6%	7%	10%
Over one year to five years	5%	0.5%	8%	7%	12%
Over five years	7.5%	1.5%	10%	8%	15%

The exceptions to the above calculation method are as follows:

(i) for any single-currency floating rate against floating rate interest rate swap, the credit equivalent amount should simply be the current exposure of the transaction; and
(ii) for any excluded exchange rate contract, the credit equivalent amount is taken as zero.

Any OTC derivative transaction not specifically covered in the above table should follow the treatment applicable to "Debt security or other commodity contracts".

Where an OTC derivative transaction conducted by the institution with a counterparty is covered by a valid bilateral netting agreement, the default risk exposure arising from that transaction should be calculated as the credit equivalent amount of the institution's net credit exposure to the counterparty, in accordance with section 95(2) of the BCR.

For any OTC derivative transactions with performance linked to an underlying "index", reporting institutions should report their exposures to the "index" as if the "index" is a counterparty, unless a different reporting treatment for such exposures has been agreed with the HKMA.

9. In relation to credit derivative contracts, the credit equivalent amount of a default risk exposure arising from such a contract (in the case of a credit default swap or total return swap) should be calculated as the sum of -

   (i) the current exposure of the contract, and
   (ii) the potential exposure of the contract, calculated by multiplying the notional principal amount of the contract by the applicable credit conversion factor set out in the table below.

	Credit default swap		Total return swap	
	Protection buyer	Protection seller*	Protection buyer	Protection seller
Qualifying reference obligation	5%	5%	5%	5%
Non-qualifying reference obligation	10%	10%	10%	10%

*The amount of potential exposure of the protection seller to the protection buyer for a credit default swap is capped at the amount of unpaid premium under the contract.

As in the case of OTC derivative transactions, where a credit derivative contract conducted by a reporting institution with a counterparty is covered by a valid bilateral netting agreement, the default risk exposure arising from that contract should be calculated as the credit equivalent amount of the institution's net credit exposure to the counterparty, in accordance with section 95(2) of the BCR.

There is no need to calculate the default risk exposure of a credit-linked note. Please refer to paragraph 11(i)(c) and (ii)(e) of this Section in relation to the reporting requirements for credit-linked notes issued or held by reporting institutions.

10. Despite paragraphs 8 and 9 of this Section, an overseas incorporated reporting institution may apply an internal approach for the reporting of its derivative exposures under this Return. Any such institution that intends to avail itself of this option should provide the HKMA with a document evidencing that the internal models used under the approach have been approved by its home supervisor for capital adequacy or large exposure purposes. The relevant document should be submitted to the designated email address "large_exposure_return@hkma.iclnet.hk" (and copied to its usual contact at the HKMA) before the institution can adopt the internal approach for reporting purposes. This is a transitional arrangement that will last until the new Standardized Approach for Counterparty Credit Risk under the Basel III capital framework is implemented in Hong Kong.

Reporting of specific types of transactions

Credit derivative contracts

11. Credit derivative contracts entered into by a reporting institution should be reported in this Return as follows:

(A) Reporting institution is protection buyer

(a) A credit default swap or a total return swap which is recognised as a protection for the underlying asset for capital adequacy purposes should be regarded as a guarantee and reported as an off-balance sheet indirect exposure (under commitments and contingencies) to the protection seller in this Return. The amount of the exposure to the protection seller is the same as the amount of protection that attracts the lower risk-weight for capital adequacy purposes.

(b) If a credit default swap or total return swap is not recognised as a protection for the underlying asset for capital adequacy purposes, report the exposure to the protection seller as a default risk exposure (according to the calculation method set out in paragraph 9 of this Section).

(c) If the reporting institution buys protection by issuing a credit-linked note which is recognised as a protection for the underlying asset for capital adequacy purposes, the institution should report its exposure to the counterparty of the underlying asset as an exposure secured by a cash deposit. The amount of the secured exposure is the amount of funds received from issuing the note. The unsecured amount, if any, of the exposure to the counterparty of the underlying asset should be reported as a direct exposure. If the credit protection is not recognised for capital adequacy purposes, the institution should report its exposure to the counterparty of the underlying asset as if the protection of the credit-linked note does not exist.

(B) Reporting institution is protection seller

(a) As a protection seller under a credit default swap or total return swap, the reporting institution should treat the swap in the same way as a direct credit substitute and report it as an off-balance sheet direct exposure (under commitments and contingencies) to the reference entity in this Return. The amount of the exposure to the reference entity is the maximum amount that could be paid out under the swap.

(b) If the reporting institution is the protection seller under a credit default swap, the institution should report, in addition to (a) above, a default risk exposure (according to the calculation method set out in paragraph 9 of this Section) to the protection buyer of the swap should the swap be subject to close-out upon the insolvency of the protection buyer whilst the reference entity is still solvent.

(c) If the reporting institution has sold protection under a credit default swap that is linked to a basket of reference entities, the institution's exposure to each reference entity in the basket should be the amount due from the institution in the event that the entity concerned is the entity that triggers the institution's obligation under the credit default swap, net of the value of credit protection.

(d) If the reporting institution is the protection seller under a total return swap, the institution should report, in addition to (a) above, a default risk exposure (according to the calculation method set out in paragraph 9 of this Section) to the protection buyer of the swap.

(e) If the reporting institution sells protection by buying a credit-linked note, the institution (as the note buyer) has (i) an on-balance sheet exposure to the note issuer; and (ii) an off-balance sheet direct exposure (under commitments and contingencies) to the reference entity because of the embedded credit default swap in the note. The institution should report the book value of the note as the amount of exposure under (i) and (ii).

Asset sales with recourse and forward asset purchases

12. Exposures of a reporting institution arising from asset sales with recourse and forward asset purchases should be reported as exposures to the issuer of the underlying assets instead of exposures to the counterparty with whom the transaction has been entered into.

Securities transactions

13. Securities transactions (i.e. transactions involving outright sale or purchase of securities) of a reporting institution should be reported on a "trade date" basis and those under "repos" (sale and repurchase agreements) and "reverse repos" should be reported on an "economic substance" approach (i.e. they are treated as collateralised deposits and loans respectively). For repos, the institution is exposed to the issuer of the securities. For reverse repos, the institution is, in the first instance, exposed to the counterparty. Only in the event of the counterparty having defaulted on the transaction would the institution be exposed to the issuer of the securities acquired. The reporting treatment of unmatured spot and forward purchases of securities and of unmatured spot and forward sales of securities should be as for repos and reverse repos respectively. Where cash is not involved in these transactions (e.g. securities repos), the institution is only exposed to the issuer of the securities delivered to the counterparty. Where the terms of a repo transfer substantially all the risks and rewards of ownership of the securities to the buyer, the transaction should be regarded as an outright sale and the commitment to repurchase should be reported as an off-balance sheet exposure to the issuer of the securities under "Off-balance sheet exposures arising from commitments and contingencies" (column (3) of Part I, II or III of this Return). Where the commitment to repurchase has no pre-determined price, the fair value (e.g. current market value) of the securities as of the reporting date should be used. On the other hand, if the institution is a buyer of securities under such repo, it should regard the transaction as an outright purchase and treat it as an on-balance sheet exposure to the issuer of the securities.

Exposures to joint accounts

14. If a reporting institution has extended loans to joint accounts the holders of which are individuals who are jointly and severally responsible for the loans, the institution should report its exposures to each of the individual holders of the joint accounts. For example, assuming that loan 1 is granted to a joint account held by individuals "A" and "B" and loan 2 is granted to another joint account held by individuals "A" and "C", the following exposures should be measured for the purpose of determining whether any of them has to be reported as a large exposure under this Return:

Borrower	Amount of loans reported
Individual A	loan 1 + loan 2
Individual B	loan 1
Individual C	loan 2

Guaranteed exposures

15. An exposure under the guarantee of a third party should, for the purposes of this Return, be regarded as an exposure to the borrower as well as the guarantor unless they both belong to the same group as mentioned in paragraph 5(i)(a) and (b) of this Section. For instance, if a reporting institution has granted the following loans to three borrowers who have no connection with the institution:

Borrower	Amount of loans expressed as % of capital base
A	10%
B	10%
C	5%

Assuming that A is the guarantor of the exposures to both B and C, these exposures should be reported as follows:

(a) If A, B and C belong to different groups - report

(i) aggregate exposures of 25% to A, being the direct exposure of 10% to A plus the guarantee on the exposures of 10% to B and 5% to C; and

(ii) the exposure of 10% to B.

Since the exposure to C is less than 10% of the institution's capital base, there is no need to report this exposure in this Return unless the exposure is among the ten largest exposures of the institution.

(b) If A and B belong to the same group - report aggregate exposures of 25% to Group A+B, being the direct exposure of 10% to A plus its guarantee on the exposure of 5% to C and the direct exposure of 10% to B.

(c) If A and C belong to the same group - report

(i) aggregate exposures of 25% to Group A+C, being the direct exposure of 10% to A plus its guarantee on the exposure of 10% to B, and the direct exposure of 5% to C; and

(ii) the exposure of 10% to B.

16. Exposures to a member of a group of related counterparties where such exposures are guaranteed by another member of the same group should be regarded as direct exposures to the whole group. Where an aggregate exposure consists of direct and indirect exposures, indicate the portion of direct exposures in percentage terms.

Exposures to central counterparties ("CCPs")

17. Reporting institutions should report their exposures to CCPs as the sum of clearing-related exposures and other exposures to such entities, the calculation method of which is set out in Annex A.

Section B: Specific Instructions

Columns (1) to (5) of Part I, II or III

18. Where an exposure has exceeded the relevant reporting threshold during the reporting period, complete columns (1) to (5) of Part I, II or III of this Return (where applicable) notwithstanding a reduction of the exposure to below the relevant threshold at the reporting date. The relevant reporting threshold is set at 5% of capital base for Part I and 10% of capital base for Part II and Part III.

19. Subject to the transitional arrangement mentioned below, report in column (1) the maximum exposure to any counterparty captured under Part I, II or III during the reporting period, in descending order of the size of exposure.

20. Reporting institutions (both locally and overseas incorporated) are allowed to report their derivative exposures based on quarter-end positions (instead of the maximum of such exposures during each reporting period) until the first quarter of 2016. This means that, on an interim basis, the value to be reported by reporting institutions in column (1) (maximum exposure in reporting period) of Part I, II or III should be the sum of their maximum exposures (excluding derivative exposures) during the reporting period and their derivative exposures at the reporting date of the period concerned. From the second quarter of 2016 onwards, reporting institutions should report their maximum exposures (including the maximum of their derivative exposures) during each reporting period.

21. Report in columns (2) to (4) of Part I, II or III the exposures at the last calendar day of the relevant quarter. Column (5) is the sum total of columns (2) to (4). It should be expressed as a percentage of the reporting institution's capital base in the next column. (Please refer to paragraph 5(iii) of Section A for definition of "capital base".)

22. In respect of on-balance sheet exposures (i.e. current exposures) arising from OTC derivative transactions and credit derivative contracts, report such exposures in column (4), instead of column (2), of Part I, II or III.

Information on security cover

23. Where the total market value of the security held by a reporting institution is equal to, or in excess of, the total exposures reported in column (5) of Part I, II or III, put an "F" in the column to indicate that the exposures are fully secured. The column should be reported as "P" (or "U") if an exposure is only partially secured (or unsecured, as the case may be). Where possible a percentage should also be given indicating the proportion of an exposure which is secured.

Part I - Exposures to any non-bank connected party equal to or exceeding 5% of capital base during the reporting period

24. Report in the table the amount of aggregate exposures, both secured and unsecured, to any non-bank connected party, which is equal to, or exceeds, 5% of the reporting institution's capital base. If an exposure to a non-bank connected party is equal to, or exceeds, 10% of the institution's capital base, such exposure should be reported in Part II again.

25. Report in "Memorandum items" the aggregate secured and unsecured exposures to non-bank connected parties outstanding as at the last day of the current quarter. These include exposures which are themselves less than 5% of the reporting institution's capital base.

Part II - Ten largest non-bank exposures (and all those equal to or exceeding 10% of capital base) during the reporting period

26. Locally incorporated reporting institutions should report their 10 largest exposures and any of their exposures which is equal to, or exceeds, 10% of their capital base.

27. Overseas incorporated reporting institutions are required to report their 10 largest exposures only.

28. Where an aggregate exposure to a group of related counterparties contains exposures to both bank and non-bank entities and the portion of non-bank exposures is equal to, or exceeds, 10% of the reporting institution's capital base as at the reporting date, the entire exposure should be reported in this Part with the portion of bank exposures indicated in percentage terms. Where the portion of non-bank exposures is less than 10% of its capital base, the institution may report the aggregate exposure in either Part II or III depending on the relative significance of the bank or non-bank exposures.

29. For the purposes of monitoring compliance with a locally incorporated reporting institution's internal clustering limit for non-exempt large exposures, the institution should also report the amount of each large exposure that is not exempted under Section 81 of the BO as at the reporting date under the column "Exposures not exempted under Section 81" and indicate its percentage to capital base.

Part III- Ten largest bank exposures (and all those equal to or exceeding 10% of capital base) during the reporting period

30. Locally incorporated reporting institutions should report their 10 largest exposures and any of their exposures which is equal to, or exceeds, 10% of their capital base.

31. Overseas incorporated reporting institutions are required to report their 10 largest exposures only.

32. Reporting institutions which provide finance to brokers and customers to subscribe for new shares are exposed indirectly to the credit risk of the receiving bank. Such indirect exposures should be reported under this Part if the total of these exposures and other

exposures to the receiving bank has exceeded the reporting threshold during the reporting period.

Hong Kong Monetary Authority
April 2015

Calculation method for exposures to CCPs

A) Clearing-related exposures

Trade exposures	The exposure value is calculated as the default risk exposure.
Segregated initial margin	The exposure value is 0.
Non-segregated initial margin	The exposure value is the nominal amount of initial margin.
Pre-funded default fund contributions	The exposure value is the nominal amount of the funded contribution.
Unfunded default fund contributions	The exposure value is 0.
Equity stakes	The exposure value is the nominal amount.

B) Other exposures

Other types of exposures that are not directly related to clearing services provided by a CCP, such as funding facilities, credit facilities, guarantees etc., should be measured according to the relevant paragraphs in the Completion Instructions for this Return, as for any other type of counterparty.