HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref: S4/7C

27 February 2017

The Chief Executive
All Authorized Institutions

Dear Sir/Madam,

Local Implementation of Basel Committee Standards on Interest Rate Risk in the Banking Book

We wrote on 28 April 2016 to draw your attention to the new standards for Interest Rate Risk in the Banking Book (IRRBB) issued by the Basel Committee on Banking Supervision (BCBS) on 21 April 2016 (www.bis.org/bcbs/publ/d368.pdf). The HKMA intends to implement these new standards by 1 January 2018, in accordance with the BCBS timetable.

The new standards can be characterised as an "outlier-based" Pillar 2 approach, meaning that regulatory capital add-ons or other supervisory actions will primarily be applied to locally incorporated authorized institutions (AIs) with IRRBB exposures (measured as change in economic value of equity resulting from a set of shock scenarios) in excess of 15% of their Tier 1 capital.

Supervisors can either mandate banks in their jurisdiction to use the standardised framework set out in the new standards or allow banks to use internal models to quantify their IRRBB exposures for regulatory purposes. We consider the standardised framework, with its six prescribed shock scenarios, to be both relevant and appropriate for the purposes of measuring the IRRBB exposures of all AIs. We therefore intend for all AIs to quantify their IRRBB exposures based on the standardised framework and (for locally incorporated AIs) to compare the results obtained under each of the prescribed scenarios with the 15% Tier 1 capital threshold, used to identify outliers according to the standards, starting from 1 January 2018.

We would however also be interested in the IRRBB figures resulting from an AI's capital adequacy assessment process (CAAP) or other internally used quantification methods. This would particularly be the case for (i) all locally incorporated AIs with IRRBB exposures based on the standardised framework exceeding the 15% Tier 1 capital threshold (i.e. "outliers") and (ii) AIs for which the outputs of internal quantification methods differ substantially from those derived under the standardised framework. Such information may be taken into account in assessing whether and to what extent any capital add-on is merited to address the IRRBB exposures of "outlier" banks as calculated under the standardised framework.

The HKMA expects to publish a consultation paper with an updated draft of the

Supervisory Policy Manual (SPM) module on Interest Rate Risk Management (IR-1) by June 2017. The updated SPM module will largely follow the new BCBS standards, with minor adjustments reflecting specific characteristics of the local banking system. In particular, no significant deviation from the BCBS standardised framework is expected. Therefore all relevant AIs are strongly recommended to start working on the relevant risk management systems and necessary processes as soon as possible, so that they are ready to report IRRBB measures based on the new standardised framework by 1 January 2018.

If you have any questions on the new IRRBB standards or on the planned local implementation approach, please feel free to contact Zijun Liu at 2878 1399 or zliu@hkma.gov.hk.

Yours faithfully,

Karen Kemp
Executive Director (Banking Policy)

cc: The Chairman, The Hong Kong Association of Banks
The Acting Chairman, The DTC Association
FSTB (Attn: Ms Eureka Cheung)