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|  <b>HONG KONG MONETARY AUTHORITY</b><br>香港金融管理局 |                                                                     |                                                                                                           |
| <b>Supervisory Policy Manual</b>                                                                                                |                                                                     |                                                                                                           |
| <b>CR-L-1</b>                                                                                                                   | <b>Consolidated Supervision of Concentration Risks: BELR Rule 6</b> | <del>V.2—09.08.19</del><br><a href="#">V.3 – (to be issued by notice in the gazette in December 2019)</a> |

This module should be read in conjunction with the [Introduction](#) and with the [Glossary](#), which contains an explanation of abbreviations and other terms used in this Manual. If reading on-line, click on blue underlined headings to activate hyperlinks to the relevant module.

## Interpretation

In this module:

- **BELR** means the Banking (Exposure Limits) Rules (Cap. 155S);
- unless specified otherwise, a reference to a Rule or a Part means a Rule or a Part respectively of the BELR

## Purpose

To set out the general principles governing the application of consolidated supervision of concentration risks and to explain how the HKMA will apply these principles

## Classification

A statutory guideline issued by the MA under the Banking Ordinance, §7(3)

## Previous guidelines superseded

Guideline 5.2.1A "Consolidated Supervision of Concentration Risks under Part XV" dated 18.10.91; Guideline 5.2.1B "Consolidated Supervision of Concentration Risks under Part XV (Solo Consolidation: Exceptions on De Minimis Grounds)" dated 19.11.91; CR-L-1 "Consolidated Supervision of Concentration Risks under Part XV: §79A" (V.1) dated 31.08.01; [CR-L-1 "Consolidated Supervision of Concentration Risks: BELR Rule 6" \(V.2\) dated 09.08.19](#)

## Application

To all locally incorporated AIs which have any subsidiaries



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### **Consolidated Supervision of Concentration Risks: BELR Rule 6**

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## 1. Introduction

### 1.1 Implementation of BELR

- 1.1.1 In July 2018, §87 of the Banking Ordinance (“the Ordinance”) on equity exposure limit was replaced by the former BELR (Cap.155R). This set of BELR was subsequently repealed and replaced by the current BELR (Cap.155S) in July 2019, which replaced all exposure limits under Part XV of the Ordinance.
- 1.1.2 §79A(1) of the Ordinance sets out the MA’s power to require an AI to comply with the provisions under Part XV of the Ordinance on different bases of consolidation. Following the implementation of the BELR, now §79A(1) is only applicable to the remaining provisions in Part XV that are not related to exposure limits.
- 1.1.3 The BELR contain provisions comparable to §79A(1) of the Ordinance under Rule 6, which are written with enhanced clarity in contemporary drafting language. Specifically, Rule 6(1) provides that the MA may, by written notice to a locally incorporated AI which has any subsidiaries, require it to apply any provision of the BELR:
- on an unconsolidated (or solo) basis;
  - on a consolidated basis in respect of the institution and 1 or more of its subsidiaries specified in the notice; or
  - on an unconsolidated basis in respect of the institution, and on a consolidated basis in respect of the institution and 1 or more of its subsidiaries specified in the notice.
- 1.1.4 For the sake of smooth transition, Part 9 provides to the effect that a former section 79A notice given to an AI is deemed, if it was in effect immediately before 1 July 2019, to be a notice given under Rule 6(1) to the institution on that date requiring it to comply with the requirements of Part 3, Part 6, Part 7 and Part 8 (cf. former §87A, 88, 81 and 83 of the Ordinance respectively) on the basis specified in the notice.



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- 1.1.5 Similarly, Part 9 also provides for carrying over the effect of a consolidation basis notice given under former Rule 5(1) of the repealed BELR (Cap. 155R) to be a notice given under Rule 6(1) in relation to compliance with Part 2 (equity exposure) of the current BELR (Cap. 155S).
- 1.1.6 Applying a provision of the BELR on the following bases means applying the provision on the basis that the business of the institution includes:
- For unconsolidated (or solo) basis: all of the institution's business in Hong Kong (being the business of its principal place of business in Hong Kong and its local branches (if any)) and the business of its branches (if any) outside Hong Kong;
  - For consolidated basis: those mentioned in the preceding bullet, and the business of its local subsidiaries or subsidiaries outside Hong Kong as may be specified in the notice given to the institution.
- 1.1.7 In respect of a notice given under Rule 6(1), the provision that is the subject matter of the notice is to be applied on the basis specified in the notice.
- 1.1.8 A subsidiary of an AI is not regarded as contravening its duty of confidentiality because of its supply of any information to the institution for enabling or assisting the institution to comply with a notice given to the institution under Rule 6(1).

## 1.2 Principles

- 1.2.1 AIs should control risks arising from concentration of exposures on a group basis, given that they may be affected by, and have to provide financial support to, any subsidiary which gets into difficulty.
- 1.2.2 The regulatory intent of the BELR would not be achieved if an AI could circumvent the statutory limits, and thereby take undue risks, by incurring exposures through its subsidiaries. The MA should therefore be able to apply such limits on a group basis, as is the case with the capital adequacy ratio.
- 1.2.3 Regulating concentration risks on a group basis also ensures that AIs have adequate systems in place for

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controlling such risks.

## 2. Supervisory approach

### 2.1 Application

- 2.1.1 The consolidation requirement extends to Als' subsidiaries only. Als with subsidiaries ~~will normally be~~[are](#) required to comply with the statutory limits on both a solo and consolidated basis<sup>1</sup>. The types of subsidiary to be included are set out in subsection 2.2 below.
- 2.1.2 Consolidated supervision complements, but does not replace, the assessment of an AI on a solo basis because:
- the AI is the entity which is authorized and takes deposits. The front line protection of depositors should therefore lie with the AI; and
  - it would be imprudent to rely on the transfer of resources or the provision of financial support from other group entities. These may turn out not to be freely transferable or available when needed. Only in exceptional circumstances and with thorough justifications will an AI be allowed not to follow solo limits.

### 2.2 Subsidiaries to be included

- 2.2.1 It may be neither practical nor meaningful to require an AI to consolidate all of its subsidiaries (particularly dormant or inactive subsidiaries) for regulatory purposes. The MA is therefore empowered under Rule 6(1) to decide which subsidiaries of an AI are to be included for the purposes of consolidation.
- 2.2.2 As a general rule, consolidation for the purpose of the BELR will include subsidiaries which:

<sup>1</sup> This always applies to Part 7, which is in line with the requirement under the "Supervisory framework for measuring and controlling large exposures" issued by the Basel Committee on Banking Supervision in April 2014 that the large exposure framework should be applied to all internationally active banks on a consolidated basis. The HKMA has discretion to apply consolidation to other Parts as appropriate.



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- undertake financial business<sup>2</sup> as they are more likely to draw on the AI's capital, should their business get into difficulty; and
- incur risks regulated by the BELR, mainly large exposures to single parties, connected lending, shareholdings and interests in land.

2.2.3 Under the capital adequacy regime, subsidiaries which are supervised by other financial regulators may be exempted from consolidation because they are subject to separate capital adequacy requirements of these regulators. Consolidation under the BELR will normally include them, however, because such financial subsidiaries are more likely to incur credit exposures than others.

2.2.4 Normally consolidation will include overseas subsidiaries which fall within the categories mentioned in para. 2.2.2, unless there is strong justification for exclusion. Where an overseas subsidiary is not allowed by local law to disclose customer information, exemption from consolidation may be given to it provided that the parent AI has adequate internal controls and limits in place to guard against the concentration of risks in it. Such controls should enable the parent AI to assess exposure with reasonable accuracy and timeliness against limits set by it and to cause the subsidiary to take action to avoid incurring additional exposure which would breach those limits and to reduce any exposure which has exceeded those limits.

2.2.5 A subsidiary which adds little to the size of an AI's balance sheet could still incur substantial risks. It is therefore inappropriate to exclude subsidiaries for consolidation based merely on size criteria.

2.2.6 AIs with an extensive group structure may have difficulty in knowing their exposure to individual counterparties at any given time. Such AIs may discuss with the HKMA arrangements to overcome difficulties in meeting the reporting and compliance requirements, e.g. through the

<sup>2</sup> Financial business normally includes factoring, banking, insurance, hire purchase, leasing, trade finance, securities trading, foreign exchange and bullion trading and other financial activities which give rise to credit exposure in a banking group.



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use of internal limits on counterparty exposure for reporting purposes. The HKMA will need to be satisfied that an AI's control systems are such that its exposure to a counterparty may reliably be taken as being no higher than the limit it adopts for that counterparty.

- 2.2.7 The HKMA will discuss with individual AIs and notify them in writing which subsidiaries will be included for consolidation. AIs should inform the HKMA of any subsequent changes in group structure, e.g. additions or deletions of subsidiaries and of changes to their subsidiaries' principal activities.

## 2.3 Tier 1 Capital

- 2.3.1 Tier 1 capital is generally the basis for applying the statutory limits under the BELR. Under Rule 2(2), the term “Tier 1 capital” for the purposes of the BELR has the meaning given by section 2(1) of the Banking (Capital) Rules. However, the determination of Tier 1 capital amount under the BELR should be subject to the basis of consolidation required under Rule 6. The subsidiaries consolidated for BELR purposes may differ from those for the calculation of the capital adequacy ratio under §97C of the Ordinance (see subsection 2.2 above).
- 2.3.2 For the purposes of determining compliance with statutory limits under the BELR, AIs should base their calculations on the Tier 1 capital prevailing at the close of business on the same day. For the sake of convenience, however, AIs may use the figure at the last quarter end as the basis, provided that there has been no significant reduction in the Tier 1 capital during the relevant period.
- 2.3.3 Where the MA requires a provision of the BELR to apply to an AI on a consolidated basis, it will be the consolidated Tier 1 capital of the AI, not the solo Tier 1 capital, that should be used for assessing compliance.
- 2.3.4 An AI's investments in subsidiaries which are not specified in the MA's notice given under Rule 6(1) will be deducted from the consolidated Tier 1 capital.

## 2.4 Solo consolidation

- 2.4.1 An AI may be permitted to consolidate certain subsidiaries



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for the purpose of compliance with exposure limits under the BELR on a solo basis. This is known as solo consolidation. Normally, a subsidiary will only be accepted for solo consolidation if all of the following apply:

- the subsidiary is wholly owned by, and managed as if it were a division of, the AI;
- the subsidiary is wholly financed by the AI, i.e. the subsidiary should have no depositors or other external creditors; and
- the capital of the subsidiary is freely transferable to the AI, after taking account of any regulatory, legal and taxation problems.

2.4.2 The purpose of the second condition set out in para. 2.4.1 above is to ensure that the assets of the subsidiary will be available, if necessary, to meet the claims of depositors and other creditors of the parent AI in a liquidation.

2.4.3 The HKMA is prepared to consider exceptions to this requirement on de minimis grounds, i.e. when the subsidiary's external liabilities (e.g. accounts payable for audit fees, company secretarial services or sundry expenses) are very small in relation to its assets. Requests for such exceptions will be considered on a case by case basis.

2.4.4 The HKMA will discuss with individual AIs and notify them in writing which subsidiaries will be included for solo consolidation.

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