Completion Instructions

Return of Capital Adequacy Ratio
Part II – Capital Base
Form MA(BS)3(II)

Introduction

1. Form MA(BS)3(II) should be completed by an authorized institution (the institution) incorporated in Hong Kong to determine its capital base for the calculation of capital adequacy ratios (CAR).

2. This Form and its completion instructions should be read in conjunction with Banking (Capital) Rules (BCR) and the relevant supervisory policy/guidance as applicable.

3. The institution shall refer to sections 2, 3 and 35 of the BCR for the interpretation of the terms used in this form and its completion instructions.

4. The overall structure of the capital base calculation according to Part 3 of the BCR is as follows –

Table A

	Components of Capital Base	**Reference to the BCR**
(A1)	Elements of Common Equity Tier 1 (CET1) Capital	Sections 38(1) and (3)
(A2)	Deductions from CET1 Capital (including items excluded under section 38(2))	Sections 38(2) and 43 to 46
(A3)	**CET1 Capital = A1 – A2**	
(A4)	Elements of Additional Tier 1 (AT1) Capital	Section 39
(A5)	Deductions from AT1 Capital	Section 47
(A6)	**AT1 Capital = A4 – A5**	
(A7)	**Tier 1 (T1) Capital = A3 + A6**	Section 37
(A8)	Elements of Tier 2 (T2) Capital	Section 40
(A9)	Deductions from T2 Capital	Section 48
(A10)	**T2 Capital = A8 – A9**	
(A11)	**Total Capital = A7 + A10**	Section 36

Specific Instructions

Item	Nature of item
Part II	**Capital Base**

5. For the purpose of calculating the institution's CAR, the capital base of the institution shall be the sum of the institution's Tier 1 capital (being the sum of the Common Equity Tier 1 (CET1) capital and Additional Tier 1 capital) and Tier 2 capital, calculated in Hong Kong dollars after taking into account items excluded under section 38(2) and regulatory deductions specified in Part 3 Division 4 and subject to the transitional arrangements specified in Schedule 4H of the BCR[1].

6. However, having considered its own circumstances, the institution may choose not to apply the transitional arrangements set out in section 5 of Schedule 4H for phasing out non-eligible capital instruments. Under that circumstance, the institution must inform the HKMA in writing of its decision, and must not change the decision thereafter without the prior consent of the HKMA.

7. The institution shall include in its CET1 capital, Additional Tier 1 capital or Tier 2 capital the proceeds of eligible instruments only to the extent that the instruments have been paid-up and are immediately available to the issuer of the instrument; or in the case of Additional Tier 1 or Tier 2 capital instruments are not issued out of an operating entity or any holding company of the institution, an operating entity or the holding company of the institution, as the case may be.

8. As outlined in paragraphs 60 and 85, if the institution has insufficient capital in a particular tier from which to make the required deductions, the remainder of the deduction amount (i.e. after bringing the net capital for that tier to zero) should be deducted from the next higher tier of capital. There are specific line items on the return to accommodate these transfers in deductions up the tiers.

9. The new regulatory capital treatments on the institution's holdings of ***non-capital LAC liabilities*** set out in the completion instructions only take effect on 1 April 2019. For the first quarter position in 2019, this Part should still be

[1] While the transitional arrangements provided to AIs in relation to (i) capital deductions and (ii) recognition of minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties in authorized institution's capital base have ceased from 1 January 2018, the phase-out of ineligible capital instruments continues until 31 December 2021.

reported based on the last version of completion instructions (i.e. 03/2018). This amended version of completion instructions should be used for reporting this Part from the second quarter position in 2019 onwards.

Item	Nature of item
Category I	**Common Equity Tier 1 capital**[2]
(a)	CET1 capital instruments

10. Report the institution's (in case it is a joint-stock company) paid-up ordinary share capital (including voting ordinary shares and ordinary shares ranking equally with voting ordinary shares in all respects except the absence of voting rights) that meets the *Qualifying Criteria to be Met to be CET1 Capital* (CET1 Qualifying Criteria) set out in Schedule 4A of the BCR **except** any shares issued by the institution by virtue of capitalizing any property revaluation reserves of the institution referred to in item (l) of Category III below.

11. Report the institution's (in case it is an entity other than a joint-stock company) capital instrument that is equivalent to ordinary shares in terms of loss absorption and meets the CET1 Qualifying Criteria set out in Schedule 4A.

(b) Share premium

12. Report the amount of the institution's share premium arising from the issue of CET1 capital instruments referred to in item (a) of Category I above.

(c) Retained earnings

13. Report in item (c) the amount of profits and losses of the institution brought forward pursuant to prevailing accounting standards as at a particular date which include the institution's –

    (i) unaudited profit or loss for the current financial year; and

    (ii) profit or loss of the immediately preceding financial year pending audit completion.

    The amount of profits and losses, if any, that has been related to sub-paragraphs (i) and (ii) above should be separately reported in item (c)(i).

[2] Any capital instruments issued to third parties via a special purpose vehicle must not be included in an institution's CET1 capital.

(d) Disclosed reserves[3]

14. Report the institution's disclosed reserves in item (d). The amount of revaluation reserves in relation to financial assets at fair value through other comprehensive income that has been included in item (d) should be separately reported in item (d)(i).

(e) Minority interests arising from CET1 capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties

15. Where the MA requires under section 3C of the BCR that the CAR of the institution is to be calculated on a ***consolidated basis*** in respect of the institution's bank subsidiaries, report in item (e) the applicable amount of minority interests, arising from the CET1 capital instruments issued by the consolidated bank subsidiaries of the institution (including retained earnings and reserves) and held by third parties, which is recognized as CET1 capital of the institution on a consolidated basis, as calculated in accordance with sections 2(1) and 3 of Schedule 4D (*Requirements to be Met for Minority Interests and Capital Instruments Issued by Consolidated Bank Subsidiaries and Held by Third Parties to be Included in Authorized Institution's Capital Base*) of the BCR.

16. The maximum amount of minority interests in the bank subsidiary that can be included in the CET1 capital of the institution on a consolidated basis is calculated as:

A – (B * C)

where:

A gross amount of total qualifying CET1 capital instruments of the bank subsidiary issued to third parties

B *(If the bank subsidiary is incorporated in Hong Kong)*

surplus CET1 capital of the subsidiary = CET1 capital of the bank subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 46 of the BCR) less the lower of –

i. the sum of risk-weighted amount for credit risk,

[3] Excluding the amount of retained earnings reported in item (c) above.

market risk and operational risk[4] of the bank subsidiary, calculated on a solo basis or a solo-consolidated basis, as the case may be, multiplied by the percentage equal to the sum of –

(I) the minimum CET1 capital ratio that the bank subsidiary must comply with, on a solo basis or a solo-consolidated basis, as the case may be, under sections 3A and 3B of the BCR, and if applicable, as varied by the MA under section 97F of the Banking Ordinance (***specified minimum ratio***); and

(II) 2.5%, or

(Item i. corresponds to the minimum CET1 capital requirement of the bank subsidiary plus the capital conservation buffer of 2.5%)

ii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk[4] of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of –

(I) the minimum CET1 capital ratio that the institution must comply with on a consolidated basis, under sections 3A and 3B of the BCR and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***specified minimum ratio***); and

(II) 2.5%.

(Item ii. corresponds to the portion, calculated as the consolidated minimum CET1 capital requirement plus the capital conservation buffer of 2.5%, that relates to the subsidiary)

Or

(If the bank subsidiary is not incorporated in Hong Kong)

surplus CET1 capital of the subsidiary = CET1 capital of the bank subsidiary (after taking into account items

[4] When the relevant provisions in relation to sovereign concentration risk set out in the Banking (Capital) (Amendment) Rules 2018 come into operation on 1 July 2019, the institution must include risk-weighted amount for sovereign concentration risk, if any, for calculating the sum of total risk-weighted amount.

under section 38(2) and deductions under sections 43 to 46 of the BCR) less –

iii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk[4] of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of –

(I) the minimum CET1 capital ratio that the institution must comply with on a consolidated basis, under sections 3A and 3B of the BCR and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***specified minimum ratio***); and

(II) 2.5%.

(Item iii. corresponds to the portion, calculated as the consolidated minimum CET1 capital requirement plus the capital conservation buffer of 2.5%, that relates to the subsidiary)

Note:

An institution may choose to use **4.5%** (***substitute percentage***) instead of the ***specified minimum ratio*** referred to in items B.i.(I), B.ii.(I) and B.iii.(I) above.

C percentage of CET1 capital instruments of the bank subsidiary held by third parties

17. The calculation as shown above must be undertaken for each individual bank subsidiary separately. If the institution has chosen to use the ***substitute percentage***, it must not, without the MA's prior consent, use the ***specified minimum ratio*** subsequently. In addition, an institution must use only either the specified minimum ratio or the ***substitute percentage*** in respect of all of its bank subsidiaries that are members of its consolidation group.

18. **Annex II-A** is an illustrative example on how to calculate the applicable amount of minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties to be included in an institution's capital base.

19. Starting from 1 January 2018, any minority interest or a

capital instrument issued by a subsidiary of the institution (that is subject to a section 3C requirement and held by third parties) which was no longer eligible for inclusion in the institution's capital base on 1 January 2013 but was included in the calculation of the institution's core capital and supplementary capital before that date should be fully excluded from the capital base of the institution.

CET1 Capital Before Deductions (A)

20. This is the sum of items (a) to (e) in Column 2.

Regulatory deductions from CET1 Capital

21. The institution must exclude/deduct items (f)(i) to (f)(xxii) from its CET1 capital, if applicable, in accordance with the provisions set out in Part 3 of the BCR.

    With respect to the regulatory deduction of an institution's LAC investments in capital instruments issued by or non-capital LAC liabilities of financial sector entities and capital investments in commercial entities, **Annex II-B** provides an illustration showing the relevant components of different types of LAC investments and loans, facilities or credit exposures that are required to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital under the BCR.

(f)(i) Cumulative cash flow hedge reserves that relate to the hedging of financial instruments that are not fair valued on the balance sheet

22. Report the amount of cumulative cash flow hedge reserves that relates to the hedging of financial instruments that are not fair valued on the balance sheet (including projected cash flows) in this item. **Net fair value losses on revaluation of cash flow hedge should be added back to the institution's CET1 capital and reported in item (f)(i) with a negative sign.**

(f)(ii) Cumulative fair value gains or losses on liabilities of the institution that are fair-valued and result from changes in the institution's own credit risk

23. Report the amount of cumulative fair value gains or losses on liabilities of the institution that are fair-valued and result from changes in the institution's own credit risk except any debit valuation adjustments for derivative contracts arising

from the institution's own credit risk referred to in item (f)(xii). **Net fair value losses on revaluation of liabilities arising from changes in the institution's own credit risk should be added back to the institution's CET1 capital and reported in item (f)(ii) with a <u>negative</u> sign.**

(f)(iii) <u>Cumulative fair value gains arising from the revaluation of land and buildings</u>

24. Report the amount of –

(i) cumulative fair value gains arising from the revaluation of the institution's holdings of land and buildings (whether for the institution's own use or for investment purposes); and

(ii) cumulative fair value gains generated from any transaction or arrangement entered into between the institution and another member of the institution's consolidation group involving the disposal of land and buildings (whether for the institution's own use or for investment purposes) that are held by the institution, or that other member, unless otherwise approved by the MA.

For the avoidance of doubt, such gains whether net or gross of deferred tax liability should be based on the prevailing accounting standards applicable within a given jurisdiction.

(f)(iv) <u>Regulatory reserve for general banking risks[5]</u>

25. Report the institution's regulatory reserve for general banking risks (either by earmarking approach or appropriation approach) referred to in section 38(2)(e) of the BCR.

(f)(v) <u>Goodwill</u>

26. Report the amount of any goodwill that is recognized by the institution as an intangible asset of the institution, net of any associated deferred tax liabilities.

(f)(vi) <u>Other Intangible Assets</u>

27. Report the amount of other intangible assets (including mortgage servicing rights) of the institution, net of any

[5] Please refer to the HKMA's Regulatory Treatment of Expected Loss Provisions under Hong Kong Financial Reporting Standard 9 in Annex II-C.

associated deferred tax liabilities. The amount of mortgage servicing rights that has been included in this item should be separately reported under item (f)(vi)(1).

(f)(vii) Defined benefit pension fund assets

28. Report the assets of any defined benefit pension fund or plan (except those of such assets to which the institution can demonstrate to the satisfaction of the MA that it has unrestricted and unfettered access), net of the amount of obligations under the fund or plan and any associated deferred tax liabilities.

(f)(viii) Deferred tax assets in excess of deferred tax liabilities

29. Report the amount of deferred tax assets, net of deferred tax liabilities (excluding those associated with and already net against the deduction of the amount of goodwill, other intangible assets and assets of any defined benefit pension fund or plan) of the institution.

30. Deferred tax assets may be netted with deferred tax liabilities only if the deferred tax assets and deferred tax liabilities relate to taxes levied by the same taxation authority and offsetting is permitted by the relevant taxation authority.

(f)(ix) Credit-enhancing interest-only strip, and any gain-on-sale and other increase in the CET1 capital arising from securitization transactions

31. Report the amount of any credit-enhancing interest-only strip, and gain-on-sale and other increase in the CET1 capital resulting from securitization transactions (whether held in the banking book or trading book) in which the institution is the originating institution.

32. The amount to be reported in item (f)(ix) of Part II should be consistent with the sum of the figures reported in items B1, B2 and B3 under "Total amount" column of Division A of Form MA(BS)3(IIId) and item B.1 under "Total" column of Division A.1(b) of Form MA(BS)3(IV).

(f)(x) Securitization exposures specified in a notice given by the MA

33. Report the amount of any securitization exposure of the institution (whether held in the banking book or trading book) that the MA may, by notice in writing given to the institution, require the institution to deduct from its CET1 capital.

34. The amount to be reported in item (f)(x) of Part II should be consistent with the sum of the figures reported in item B4 under "Total amount" column of Division A of Form MA(BS)3(IIId) and item B.2 under "Total" column of Division A.1(b) of Form MA(BS)3(IV).

(f)(xi) Valuation adjustments

35. Where the application of paragraph 4.5 of the SPM module on "Financial Instrument Fair Value Practices" (CA-S-10) has led to a lower carrying value than actually recognized under the current financial reporting standards as a result of valuation adjustments made, the absolute value of the difference should be reported in item (f)(xi) except:

(i) if that exposure is a financial instrument that gives rise to the cash flow hedge reserves that fall within item (f)(i) above; and

(ii) such part of the absolute value that have been taken into account in the calculation of the amount of the institution's retained earnings or other disclosed reserves (or part of the retained earnings or other disclosed reserves) that fall within items (c) and (d) above.

(f)(xii) Debit valuation adjustments (DVAs) in respect of derivative contracts

36. Report the amount of any DVAs made by the institution in respect of derivative contracts arising from the institution's own credit risk (which must not be offset by any accounting valuation adjustments arising from the institution's counterparty credit risk).

(f)(xiii) Excess of *total EL amount* over *total eligible provisions*[6] under the IRB Approach

37. For an institution that adopts the IRB approach for its credit risk, if its total EL amount exceeds its total eligible provisions, it must deduct the excess amount of total EL amount over total eligible provisions from the institution's CET1 capital.

(f)(xiv) Cumulative losses below depreciated cost arising from the

[6] Please refer to the HKMA's Regulatory Treatment of Expected Loss Provisions under Hong Kong Financial Reporting Standard 9 in Annex II-C.

institution's holdings of land and buildings

38. Report any cumulative losses[7] of the institution arising from the institution's holdings of land and buildings below the depreciated cost value (whether or not any such land and buildings are held for the institution's own-use or for investment purposes) referred to in section 41(4) of the BCR.

(f)(xv) Capital shortfall of regulated non-bank subsidiaries

39. Report the amount of any relevant capital shortfall as specified in a notice under section 45(1)(b) of the BCR given to the institution in respect of a subsidiary of the institution that is a securities firm or insurance firm.

40. The capital shortfall amount to be reported in item (f)(xv) is in addition to any other deductions the institution is required to make above, as applicable, from its CET1 capital in respect of the subsidiary concerned of the institution; and represents the amount by which that subsidiary is deficient in meeting its minimum capital requirements.

41. For the avoidance of doubt, the institution's investment in any of its subsidiary securities and/or insurance firms which are subject to deductions above, as applicable, should be net of any goodwill relating to such investment in subsidiary securities and/or insurance firms which is already deducted from CET1 capital and reported in item (f)(v) above.

(f)(xvi) Investments in own CET1 capital instruments

42. Report the amount of any direct, indirect and synthetic holdings by the institution of its own CET1 capital instruments, unless already derecognized under applicable accounting standards, calculated in accordance with Schedule 4E of the BCR. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (f)(xvi) by

[7] The "cumulative losses" here refer to the losses represented by any negative difference between the fair value and the depreciated cost value of the institution's properties (the latter is calculated as the cost of the building minus its accumulated depreciation, if any). To the extent that any amount of such "cumulative losses" has not been recognised as "impairment loss" through profit and loss account, the amount will need to be deducted from CET1 capital.

any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the BCR; and

(iii) include in the amount to be deducted under item (f)(xvi) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

(f)(xvii) <u>Reciprocal cross holdings in CET1 capital instruments</u>

43. Report the amount of any direct, indirect and synthetic holdings by the institution of CET1 capital instruments issued by any financial sector entities where that entity has a reciprocal cross holding with the institution. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (f)(xvii) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the BCR; and

(iii) include in the amount to be deducted under item (f)(xvii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is

beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

(f)(xviii) Capital investment in a connected company which is a commercial entity

(f)(xviii)(1) Loans, facilities or other credit exposures that is required by section 46(1) of BCR to be aggregated with item (f)(xviii)

44. Report in item (f)(xviii) the amount of the sum of the following to the extent that such sum is in excess of 15% of the capital base of the institution as reported in its capital adequacy ratio return as at the immediately preceding calendar quarter end date:

(i) the net book value of any capital investment in a connected company of the institution where that connected company is a commercial entity; and

(ii) any loans, facilities or other credit exposures provided by the institution to any connected company of the institution where the connected company is a commercial entity as if such loans, facilities or other credit exposures were direct capital investment by the institution in the commercial entity, except where the institution demonstrates to the satisfaction of the MA that any such loan was made, facility granted or other credit exposure incurred in the ordinary course of business.

45. Report separately in item (f)(xviii)(1) the amount of any loans, facilities or other credit exposures described in paragraph 44(ii) above that is included in the amount reported in item (f)(xviii).

(f)(xix) Insignificant LAC investments in CET1 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement and not covered by the 10% threshold

(f)(xix)(1) Loans, facilities or other credit exposures that is required by section 46(2) of BCR to be aggregated with item (f)(xix)

46. Subject to paragraphs 47 and 48, report in item (f)(xix) the sum of the applicable amounts of the following:

(i) the amount of direct, indirect and synthetic holdings of CET1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4F of the BCR, if – (a) the entities are not

the subject of consolidation under a section 3C requirement; (b) the holdings are ***insignificant LAC investments***; and (c) the holdings do not otherwise fall within items (f)(xvi) and (f)(xvii) above; and

(ii) any loans, facilities or other credit exposures provided by the institution to any connected companies of the institution where the connected company is a financial sector entity, except where the institution demonstrates to the satisfaction of the MA that any such loan was made, facility was granted or any such other credit exposure was incurred in the ordinary course of the institution's business.

47. For the purposes of paragraph 46(i), the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (f)(xix) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the BCR; and

(iii) include in the amount to be deducted under item (f)(xix) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

48. The applicable amount to be deducted from the institution's CET1 capital under paragraph 46 above should be determined by the formula in the first column of the following table:

Applicable Amount	**Reference to Schedule 4F of the BCR**
(For deduction of holdings by an institution that is a "***section 2 institution***" as defined in section 2 of Schedule 4F to the BCR[8])	
Excess(10% threshold)(net long) * CET1 percentage	Sections 1, 2, 4
(For deduction of holdings by an institution that is a "***section 3 institution***" (within the meaning of section 3 of Schedule 4F to the BCR) or treated as such by virtue of section 2(2) of Schedule 4F)	
Excess(10% threshold)(net long) * CET1 percentage	Sections 1, 3, 4

Annex II-D is an illustrative example on how to calculate the applicable amount of insignificant and significant LAC investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

49. Report separately in item (f)(xix)(1) the amount of any loans, facilities or other credit exposures described in paragraph 46(ii) above that is included in the amount reported in item (f)(xix).

50. The amount of insignificant LAC investments issued by financial sector entities that do not exceed the 10% threshold referred to in paragraph 48 above and that are not deducted from an institution's CET1 capital is to continue to be risk-weighted in accordance with the applicable risk-weight under Part 4, 5, 6 or 8 of the BCR, as the case requires.

(f)(xx) Significant LAC investments in CET1 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement and not covered by the 10% threshold

(f)(xx)(1) Loans, facilities or other credit exposures provided that is required by section 46(2) of BCR to be aggregated with item (f)(xx)

51. Subject to paragraphs 52 and 53, report in item (f)(xx) the sum of the applicable amounts of the following:

    (i) the amount of the institution's direct, indirect and synthetic holdings of CET1 capital instruments issued

[8] (Viz., a ***resolution entity*** or ***material subsidiary*** but exclude any material subsidiary that has obtained the MA's prior consent to be treated as a "section 3 institution" (within the meaning of section 3 of Schedule 4F)).

by financial sector entities, calculated in accordance with Schedule 4G, if – (a) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution; (b) the holdings are ***significant LAC investments***; and (c) the holdings do not otherwise fall within items (f)(xvi) and (f)(xvii) above; and

(ii) any loans, facilities or other credit exposures provided by the institution to any connected company of the institution where the connected company is a financial sector entity, except where the institution demonstrates to the satisfaction of the MA that any such loan was made, facility was granted, or any such other credit exposure was incurred, in the ordinary course of the institution's business.

52. For the purposes of paragraph 51(i), the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (f)(xx) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the BCR; and

(iii) include in the amount to be deducted under item (f)(xx) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

53. For the purpose of determining the applicable amount of an institution's significant LAC investment in CET1 capital instruments issued by financial sector entities referred to in paragraph 51 above, such amount must be calculated by:

(G – H)

where:

G gross amount of the institution's significant LAC investments that are CET1 capital instruments issued by and credit exposures to financial sector entities, as described in paragraphs 51(i) and (ii) above

H 10% of the institution's CET1 capital, calculated after applying all deductions under items (f)(i) to (f)(xix), (f)(xxi) and (f)(xxii)

Annex II-D is an illustrative example on how to calculate the applicable amount of insignificant and significant LAC investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

54. Report separately in item (f)(xx)(1) the amount of any loans, facilities or other credit exposures described in paragraph 51(ii) above that is included in the amount reported in item (f)(xx).

55. The amount of an institution's significant LAC investments that are CET1 capital instruments of a financial sector entity that does not exceed the 10% threshold referred to in paragraph 53 above and that is not deducted from its CET1 capital must be risk-weighted at 250%.

(f)(xxi) Direct holdings of CET1 capital instruments issued by financial entities that are members of the institution's consolidation group

(f)(xxi)(1) Loans, facilities or other credit exposures that is required by section 46(2) of BCR to be aggregated with item (f)(xxi)

56. Items (f)(xxi) and (f)(xxi)(1) are applicable only for institution who calculates its CAR on a solo/solo-consolidated basis under a section 3C requirement.

57. Subject to paragraph 58, report in item (f)(xxi) the sum of the applicable amounts of the following:

(i) the institution's direct holdings of CET1 capital instruments issued by financial sector entities that are members of the institution's consolidation group; and

(ii) any loans, facilities or other credit exposures provided by the institution to any connected companies of the institution where the connected company is a financial sector entity, except where the

institution demonstrates to the satisfaction of the MA that any such loan was made, facility granted or other credit exposure incurred in the ordinary course of the institution's business.

58. For the purposes of paragraph 57(i) above, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (f)(xxi) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the BCR; and

(iii) include in the amount to be deducted under item (f)(xxi) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

59. Report separately in item (f)(xxi)(1) the amount of any loans, facilities or other credit exposures described in paragraph 57(ii) above that is included in the amount reported in item (f)(xxi).

(f)(xxii) <u>Regulatory deductions applied to CET1 capital due to insufficient Additional Tier 1 capital to cover the required deductions</u>

60. The institution should deduct from its CET1 capital the amount required to be deducted from Additional Tier 1 capital by virtue of section 47 of the BCR that exceeds the Additional Tier 1 capital of the institution.

61. If the institution's Additional Tier 1 capital before deductions **(C)** is less than the sum of deduction items (i)(i) to (i)(vi), then:

- report "0" in Additional Tier 1 capital after deductions **(D)**; and

- report the sum of items (i)(i) to (i)(vi) minus Additional Tier 1 capital before deductions **(C)** in item (f)(xxii).

CET1 Capital After Deductions **(B)**

62. This is the sum of items (a) to (e) in Column 2 after making the deductions specifically required from CET1 capital (i.e. items (f)(i) to (f)(xxii)).

63. This is also the figure to be reported in item 1.1(i) of Division A of Form MA(BS)3(I).

Category II **Additional Tier 1 capital**

(g) Additional Tier 1 capital instruments issued and share premium

(g)(i) Amount of capital instruments reported in item (g) that is subject to phase out

64. Report in item (g) the amount of:

(i) the institution's capital instruments that meet the *Qualifying Criteria to be Met to be Additional Tier 1 Capital* (AT1 Qualifying Criteria) set out in Schedule 4B of the BCR;

(ii) the amount of the institution's share premium arising from the issue of capital instruments referred to in sub-paragraph (i) above; and

(iii) the amount of capital instruments no longer qualified for inclusion in capital base after 1 January 2013 but eligible to be phased out from that date.

65. With respect to paragraph 64(iii) above, the capital instruments of the institution that were included in the institution's capital base immediately before 1 January 2013 but do not meet all the AT1 Qualifying Criteria set out in Schedule 4B must be phased out during the 10-year transition period beginning from that date. Report separately in item (g)(i) the amount of capital instruments issued before 1 January 2013 which are eligible to be phased out based on the transitional arrangements set out in **Annex II-E**.

Annex II-F contains an illustration for determining the extent of recognition of capital instruments as regulatory capital during the phase out period.

66. Additional Tier 1 capital instruments issued to third parties by the institution through a special purpose vehicle may be included in the Additional Tier 1 capital of the institution on a consolidated basis as if the institution itself had issued the capital instruments directly to third parties, provided that:

(i) the special purpose vehicle is consolidated with the institution;

(ii) the capital instruments meet the AT1 Qualifying Criteria set out in Schedule 4B of the BCR; and

(iii) the only asset of the special purpose vehicle is its investment in the capital of the institution in a form that

meets the AT1 Qualifying Criteria set out in Schedule 4B of the BCR[9].

(h) Applicable amount of capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties

67. Where the MA requires under section 3C of the BCR that the CAR of the institution is to be calculated on a ***consolidated basis*** in respect of the institution's bank subsidiaries, report in item (h) the applicable amount of capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties, which is recognized as Additional Tier 1 capital of the institution on a consolidated basis, and calculated in accordance with sections 2(2) and 4 of Schedule 4D (*Requirements to be Met for Minority Interests and Capital Instruments Issued by Consolidated Bank Subsidiaries and held by Third Parties to be included in Authorized Institution's Capital Base*) of the BCR.

68. The maximum amount of Tier 1 capital instruments (i.e. CET1 capital instruments and Additional Tier 1 capital instruments) issued by the bank subsidiary to third parties that can be included in the Tier 1 capital of the institution on a consolidated basis is calculated as:

A – (B * C)

where:

A gross amount of total qualifying Tier 1 capital instruments of the bank subsidiary issued to third parties

B *(If the bank subsidiary is incorporated in Hong Kong)*

surplus Tier 1 capital of the bank subsidiary = Tier 1 capital of the bank subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 47 of the BCR) less the lower of

i. the sum of risk-weighted amount for credit risk, market risk and operational risk[4] of the bank subsidiary, calculated on a solo basis or a solo-consolidated basis, as the case may be, and multiplied by the percentage equal to the sum of–
(I) the minimum Tier 1 capital ratio that the

[9] Assets that relate to the operation of the SPV may be excluded from this assessment if they are de minimis.

bank subsidiary must comply with, on a solo basis or a solo-consolidated basis, as the case may be, under sections 3A and 3B of the BCR, and if applicable, as varied by the MA under section 97F of the Banking Ordinance (***specified minimum ratio***); and

(II) 2.5%, or

(Item i. corresponds to the minimum Tier 1 capital requirement of the bank subsidiary plus the capital conservation buffer of 2.5%)

ii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk[4] of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of–

(I) the minimum Tier 1 capital ratio that the institution must comply with, on a consolidated basis, under sections 3A and 3B of the BCR and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***specified minimum ratio***); and

(II) 2.5%.

(Item ii. corresponds to the portion, calculated as the consolidated minimum Tier 1 capital requirement plus the capital conservation buffer of 2.5%, that relates to the subsidiary)

Or

(If the bank subsidiary is not incorporated in Hong Kong)

surplus Tier 1 capital of the bank subsidiary = Tier 1 capital of the bank subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 47 of the BCR) less –

iii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk[4] of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of –

(I) the minimum Tier 1 capital ratio that the institution must comply with, on a consolidated basis, under sections 3A and

3B of the BCR and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***specified minimum ratio***); and

(II) 2.5%.

(Item iii. corresponds to the portion, calculated as the consolidated minimum Tier 1 capital requirement plus the capital conservation buffer of 2.5%, that relates to the subsidiary)

Note:

An institution may choose to use **6%** (***substitute percentage***) instead of the ***specified minimum ratio*** referred to in items B.i.(I), B.ii.(I) and B.iii.(I) above.

C percentage of Tier 1 capital instruments of the bank subsidiary held by third parties

69. The amount of Tier 1 capital recognized in the Additional Tier 1 capital of an institution on a consolidated basis must exclude the portion that has been recognized in the consolidated CET1 capital under paragraph 15 above.

70. The calculation as shown above must be undertaken for each individual bank subsidiary separately. If the institution has chosen to use the ***substitute percentage***, it must not, without the MA's prior consent, use the specified minimum ratio subsequently. In addition, the institution must use only either the ***specified minimum*** ratio or the substitute percentage in respect of all of its bank subsidiaries that are members of its consolidation group.

71. **Annex II-A** is an illustrative example on how to calculate the applicable amount of minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties to be included in the institution's capital base.

72. Starting from 1 January 2018, any minority interest or a capital instrument issued by a subsidiary of the institution (that is subject to a section 3C requirement and held by third parties) which was no longer eligible for inclusion in the institution's capital base on 1 January 2013 but was included in the calculation of the institution's core capital before that date should be fully excluded from the capital base of the institution.

73. If the institution issues capital instrument to third parties through a special purpose vehicle via a consolidated bank subsidiary of the institution and -

(i) the special purpose vehicle is consolidated with the bank subsidiary;

(ii) the capital instruments meet the AT1 Qualifying Criteria set out in Schedule 4B of the BCR; and

(iii) the only asset of the special purpose vehicle is its investment in the capital of the bank subsidiary in a form that meets the AT1 Qualifying Criteria set out in Schedule 4B of the BCR[10],

the institution may treat the capital institutions as if the bank subsidiary itself had issued the capital instrument directly to the third parties, and may include the capital instruments in determining the applicable amount of the capital instruments to be included in the Additional Tier 1 capital of the institution on a consolidated basis as stipulated in paragraph 67 above.

Additional Tier 1 Capital Before Deductions (C)

74. This is the sum of items (g) and (h) in Column 2.

Regulatory deductions from Additional Tier 1 Capital

75. The institution must deduct the following items from its Additional Tier 1 capital in accordance with the provisions set out in Part 3 of the BCR.

With respect to the regulatory deduction of an institution's LAC investments in capital instruments issued by and non-capital LAC liabilities of financial sector entities and capital investments in commercial entities, **Annex II-B** provides an illustration showing the relevant components of different types of LAC investments and loans, facilities or credit exposures that are required to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital under the BCR.

(i)(i) Investments in own Additional Tier 1 capital instruments

[10] Assets that relate to the operation of the SPV may be excluded from this assessment if they are de minimis.

76. Report the amount of any direct, indirect and synthetic holdings by the institution of its own Additional Tier 1 capital instruments, unless already derecognized under applicable accounting standards, calculated in accordance with the provisions of Schedule 4E of the BCR. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (i)(i) by any amount of goodwill (related to any holdings of Additional Tier 1 capital instruments falling within other items) already deducted under section 43(1)(a) of the BCR; and

(iii) include in the amount to be deducted under item (i)(i) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

(i)(ii) <u>Reciprocal cross holdings in Additional Tier 1 capital instruments</u>

77. Report the amount of any direct, indirect and synthetic holdings by the institution of Additional Tier 1 capital instruments issued by financial sector entity where that entity has a reciprocal cross holding with the institution. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (i)(ii) by any amount of goodwill (related to any holdings of

shares falling within other items) already deducted under section 43(1)(a) of the BCR; and

(iii) include in the amount to be deducted under item (i)(ii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

(i)(iii) <u>Insignificant LAC investments in Additional Tier 1 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement and not covered by the 10% threshold</u>

78. Subject to paragraph 79 below, report the applicable amount of the institution's direct, indirect and synthetic holdings of Additional Tier 1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4F of the BCR, if – (a) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution; (b) the holdings are insignificant LAC investments; and (c) the holdings do not otherwise fall within items (i)(i) and (i)(ii) above. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (i)(iii) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the BCR; and

(iii) include in the amount to be deducted under item (i)(iii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the

regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

79. The applicable amount to be deducted from the institution's Additional Tier 1 capital under paragraph 78 above should be determined by the formula in the first column of the following table:

Applicable amount	**Reference to Schedule 4F of the BCR**
(For deduction of holdings by an institution that is a "section 2 institution" as defined in section 2 of Schedule 4F to the BCR[11])	
Excess(10% threshold)(net long) * AT1 percentage	Sections 1, 2, 4
(For deduction of holdings by an institution that is a "section 3 institution" (within the meaning of section 3 of Schedule 4F to the BCR) or treated as such by virtue of section 2(2) of Schedule 4F)	
Excess(10% threshold)(net long) * AT1 percentage	Sections 1, 3, 4

Annex II-D is an illustrative example on how to calculate the applicable amount of insignificant and significant LAC investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

80. The amount of insignificant LAC investments issued by financial sector entities that do not exceed the 10% threshold referred to in paragraph 79 above, and therefore not deducted from an institution's Additional Tier 1 capital, is to continue to be risk-weighted in accordance with the applicable risk-weight under Part 4, 5, 6 or 8 of the BCR, as the case requires.

(i)(iv) Significant LAC investments in Additional Tier 1 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement

[11] (Viz., a ***resolution entity*** or ***material subsidiary*** but exclude any material subsidiary that has obtained the MA's prior consent to be treated as a "section 3 institution" (within the meaning of section 3 of Schedule 4F)).

81. Subject to paragraph 82 below, report the amount of the institution's direct, indirect and synthetic holdings of Additional Tier 1 capital instruments issued by financial sector entities, calculated in accordance with Schedule 4G of the BCR, if – (a) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution; (b) the holdings are significant LAC investments; and (c) the holdings do not otherwise fall within items (i)(i) and (i)(ii) above. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (i)(iv) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the BCR; and

(iii) include in the amount to be deducted under item (i)(iv) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

82. All significant LAC investments in capital instruments issued by financial sector entities that are not in the form of CET1 capital instruments must be fully deducted from an authorized institution's Additional Tier 1 capital or Tier 2 capital, as the case requires, by reference to the tier of capital for which the capital instruments would qualify if they were issued by the institution itself.

Annex II-D is an illustrative example on how to calculate the applicable amount of insignificant and significant LAC investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

(i)(v) Direct holdings of Additional Tier 1 capital instruments issued by financial sector entities that are members of the institution's consolidation group

83. Item (i)(v) is applicable only for institution who calculates its CAR on a solo/solo-consolidated basis under a section 3C requirement.

84. Report the amount of the institution's direct holdings of Additional Tier 1 capital instruments issued by financial sector entities that are members of the institution's consolidation group. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate;

(ii) reduce the amount to be deducted under item (i)(v) by any amount of goodwill (related to any holdings of shares falling within other items) already deducted under section 43(1)(a) of the BCR; and

(iii) include in the amount to be deducted under item (i)(v) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

(i)(vi) Regulatory deductions applied to Additional Tier 1 capital due to insufficient Tier 2 capital to cover the required deductions

85. The institution is required to make from its Tier 2 capital any regulatory deductions by virtue of section 48 of the BCR. Such deductions must be applied to Additional Tier 1 capital in case Tier 2 capital of the institution is not sufficient to cover the required deductions.

86. If the institution's Tier 2 capital before deductions **(F)** is less than the sum of deduction items (r)(i) to (r)(viii), then:

- report "0" in Tier 2 capital after deductions **(G)**; and

- report the sum of items (r)(i) to (r)(viii) minus Tier 2 capital before deductions **(F)** in item (i)(vi).

Additional Tier 1 Capital After Deductions **(D)**

87. This is the sum of items (g) and (h) in Column 2 after making the deductions specifically required from Additional Tier 1 capital (i.e. items (i)(i) to (i)(vi)). However, if an institution's Additional Tier 1 capital before deductions **(C)** is less than the sum of deduction items (i)(i) to (i)(vi), then report "0" in Additional Tier 1 capital deductions **(D)** and follows the instructions set out in paragraph 61.

88. This is also the figure to be reported in item 1.1(ii) of Division A of Form MA(BS)3(I).

Tier 1 Capital **(E)**

89. This is the sum of CET1 capital after deductions **(B)** and Additional Tier 1 capital after deductions **(D)**.

90. This is also the figure to be reported in item 1.1 of Division A of Form MA(BS)3(I).

Item	Nature of item
Category III	**Tier 2 Capital**
(j)	Tier 2 capital instruments issued and share premium
(j)(i)	Amount of capital instruments reported in item (j) that is subject to phase out arrangements

91. Report in item (j) the amount of:

    (i) the institution's capital instruments that meet the Tier 2 Qualifying Criteria as specified in Schedule 4C of the BCR;

    (ii) the amount of the institution's share premium arising from the issue of capital instruments referred to in sub-paragraph (i) above; and

    (iii) the amount of capital instruments no longer qualified for inclusion in capital base after 1 January 2013 but eligible to be phased out from that date.

92. With respect to paragraph 91(iii), the capital instruments of the institution that were included in the institution's capital base immediately before 1 January 2013 but that do not meet all the qualifying criteria set out in Schedule 4C must be phased out during the 10-year transition period beginning from that date. Report separately in item (j)(i) the amount of capital instruments issued before 1 January 2013 which are eligible to be phased out based on the transitional arrangements set out in **Annex II-E**.

    Annex II-F contains an illustration for determining the extent of recognition of capital instruments as regulatory capital during the phase out period.

93. Tier 2 capital instruments issued to third parties by the institution through a special purpose vehicle may be included in the Tier 2 capital of the institution on a consolidated basis as if the institution itself had issued the capital instruments to third parties, provided that:

    (i) the special purpose vehicle is consolidated with the institution;

    (ii) the capital instruments meet the qualifying criteria set out in Schedule 4C of the BCR; and

    (iii) the only asset of the special purpose vehicle is its

investment in the capital of the institution in a form that meets the Tier 2 Qualifying Criteria set out in Schedule 4C of the BCR[12].

(k) Applicable amount of capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties

94. Where the MA requires under section 3C of the BCR that the CAR of the institution is to be calculated on a ***consolidated basis*** in respect of the institution's bank subsidiaries, report in item (k) the applicable amount of capital instruments issued by the consolidated bank subsidiaries of the institution and held by third parties, which is recognized as Tier 2 capital of the institution on a consolidated basis, and calculated in accordance with sections 2(2) and 5 of Schedule 4D (*Requirements to be Met for Minority Interests and Capital Instruments Issued by Consolidated Bank Subsidiaries and held by Third Parties to be included in Authorized Institution's Capital Base*) of the BCR.

95. The maximum amount of all capital instruments (i.e. CET1 capital instruments, Additional Tier 1 capital instruments and Tier 2 capital instruments) issued by the bank subsidiary to third parties that can be included in the Total capital of the institution on a consolidated basis is calculated as:

A – (B * C)

where:

A gross amount of total qualifying capital instruments of the bank subsidiary issued to third parties

B *(If the bank subsidiary is incorporated in Hong Kong)*

surplus Total capital of the subsidiary = Total capital of the subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 48 of the BCR) less the lower of –

i. the sum of risk-weighted amount for credit risk, market risk and operational risk[4] of the bank subsidiary, calculated on a solo basis or a solo-consolidated basis, as the case may be, and multiply by the percentage equal to the sum of –

[12] Assets that relate to the operation of the SPV may be excluded from the assessment if they are de minimis.

(I) the minimum Total capital ratio that the bank subsidiary must comply with, on a solo basis or a solo-consolidated basis, as the case may be, under sections 3A and 3B of the BCR, and if applicable, as varied by the MA under section 97F of the Banking Ordinance (***specified minimum ratio***); and

(II) 2.5%, or

(Item i. corresponds to the minimum Total capital requirement of the bank subsidiary plus the capital conservation buffer of 2.5%)

ii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk[4] of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of –

(I) the minimum Total capital ratio that the institution must comply with on a consolidated basis, under sections 3A and 3B of the BCR and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***specified minimum ratio***); and

(II) 2.5%.

(Item ii. corresponds to the portion, calculated as the consolidated minimum Total capital requirement plus the capital conservation buffer of 2.5% that relates to the subsidiary)

Or

(If the bank subsidiary is not incorporated in Hong Kong)

surplus Total capital of the subsidiary = Total capital of the subsidiary (after taking into account items under section 38(2) and deductions under sections 43 to 48 of the BCR) less –

iii. the portion of the sum of risk-weighted amount for credit risk, market risk and operational risk[4] of the institution calculated on a consolidated basis, that relates to the bank subsidiary, multiply by the percentage equal to the sum of –

(I) the minimum Total capital ratio that the institution must comply with on a

consolidated basis, under sections 3A and 3B of the BCR and, if applicable, as varied by the MA under section 97F of the Banking Ordinance (***specified minimum ratio***); and

(II) 2.5%.

(Item iii. corresponds to the portion, calculated as the consolidated minimum Total capital requirement plus the capital conservation buffer of 2.5% that relates to the subsidiary)

Note:

An institution may choose to use **8%** (***substitute percentage***) instead of the ***specified minimum ratio*** referred to in items B.i.(I), B.ii.(I) and B.iii.(I) above.

C percentage of total capital instruments of the subsidiary held by third parties

96. The amount of Total capital recognized in the Tier 2 capital of an institution on a consolidated basis must exclude the portion that has been recognized in the consolidated Tier 1 capital under paragraph 67 above.

97. The calculation as shown above must be undertaken for each individual bank subsidiary separately. If the institution has chosen to use the substitute percentage, it must not, without the MA's prior consent, use the specified minimum ratio subsequently. In addition, the institution must use only either the specified minimum ratio or the substitute percentage in respect of all the bank subsidiaries of the institution that are members of its consolidation group.

98. **Annex II-A** is an illustrative example on how to calculate the applicable amount of minority interests and capital instruments issued by consolidated bank subsidiaries and held by third parties to be included in authorized institution's capital base.

99. Starting from 1 January 2018, any minority interest or a capital instrument issued by a subsidiary of the authorized institution (that is subject to a section 3C requirement and held by third parties) which was no longer eligible for inclusion in the institution's capital base on 1 January 2013 but was included in the calculation of the institution's supplementary capital before that date should be fully excluded from the capital base of the institution.

100. If the institution issues Tier 2 capital instrument to third parties through a special purpose vehicle via a consolidated bank subsidiary and -

(i) the special purpose vehicle is consolidated with the bank subsidiary;

(ii) the capital instruments meet the Tier 2 Qualifying Criteria set out in Schedule 4C of the BCR; and

(iii) the only asset of the special purpose vehicle is its investment in the capital of the bank subsidiary in a form that meets the Tier 2 Qualifying Criteria set out in Schedule 4C of the BCR[13],

the institution may treat the capital institutions as if the bank subsidiary itself had issued the capital instrument directly to third parties, and may include the capital instruments in determining the applicable amount of the capital instruments to be included in the consolidated Additional Tier 1 capital of the institution as mentioned in paragraph 94 above.

(l) Reserves attributable to fair value gains on revaluation of the institution's holdings of land and buildings[14]

101. Subject to paragraphs 102, 103, 104 and 106, report in this item the institution's reserves and retained earnings that is attributable to fair value gains arising from:

(i) the revaluation of the institution's holdings of land and buildings except land and buildings mortgaged to the institution to secure a debt;

(ii) the revaluation of the institution's share of the net asset value of any subsidiary of the institution to the extent that the value has changed as a result of the revaluation of the subsidiary's holdings of land and buildings except any land and buildings mortgaged to the subsidiary to secure a debt; and

(iii) disposal of land and buildings (whether for the institution's own-use or for investment purposes)

[13] Assets that relate to the operation of the SPV may be excluded from the assessment if they are de minimis.

[14] According to sections 29, 30 and 31 of the BCR, the institution is allowed to deduct the portion of reserves not recognized in Tier 2 capital (i.e. the amount of the 55% haircut) from the institution's total risk-weighted amount. Such deductible amount should be reported in item 2.12(ii) of Division A of Form MA(BS)3(I).

referred to in section 38(2)(d) of the BCR.

Provided that:

(a) the institution has a clearly documented policy on the frequency and method of revaluation of its holdings of land and buildings that is satisfactory to the MA;

(b) the institution does not depart from that policy except after consultation with the MA;

(c) subject to sub-paragraph (d) below, any revaluation of the institution's holdings of land and buildings is undertaken by an independent professional valuer;

(d) in any case where the institution demonstrates to the satisfaction of the MA that, despite all reasonable efforts, it has been unable to obtain the services of an independent professional valuer to undertake the revaluation of all or part, as the case may be, of the institution's holdings of land and buildings, any revaluation of such holdings undertaken by a person who is not an independent professional valuer is endorsed in writing by an independent professional valuer;

(e) any revaluation of the institution's holdings of land and buildings is approved by the institution's external auditors of the institution and explicitly reported in the institution's audited accounts; and

(f) the fair value gains relating to paragraphs 101(i) to (iii) above are recognized in accordance with applicable accounting standards and any such gains not recognized in the financial statements of the institution are excluded.

102. The shares issued by the institution through capitalizing that part of the institution's reserves and retained earnings that is attributable to fair value gains described in paragraph 101 above is allowed to be added back in the institution's Tier 2 capital.

103. The amount of the fair value gains on revaluation of each of paragraphs 101(i) to (iii) above, which may be included in Tier 2 capital, shall not exceed 45% of each of such fair value gains (i.e. applying a haircut of 55% to each of such gains).

104. The institution must not, in calculating its Tier 2 capital, set-off losses in respect of the institution's own use land and buildings where such losses are recognized in the institution's profit or loss against unrealized gains that are reflected directly in the institution's equity through the statement of changes in equity.

105. The institution must deduct from its CET1 capital any cumulative losses of the institution arising from the institution's holdings of land and buildings below the depreciated cost value (whether or not any such land and buildings are held for the institution's own-use or for investment purposes). Such amount, if any, is to be reported in item (f)(xiv) above.

106. For the purposes of item (l), reserves attributable to fair value gains on revaluation of the institution's holdings of land and buildings. Whether the amount should be net or gross of deferred tax liability should be based on the prevailing accounting standards applicable within a given jurisdiction.

(m), (n) & (o) Regulatory reserve for general banking risks and collective provisions[15] [16]

107. For an institution which uses only the STC approach or BSC approach to calculate its credit risk for non-securitization exposures, the institution must–

(i) report its regulatory reserve for general banking risks in item (m) and collective provisions in item (n); and

(ii) report the total of items (m) and (n) in item (o) up to an amount not exceeding 1.25% of the institution's aggregate risk-weighted amount for credit risk calculated by using the STC approach or BSC approach and by using any of the SEC-ERBA, SEC-SA and SEC-FBA. However, the risk-weighted amounts of exposures to CCPs and CVA, if any, are excluded.

108. For an institution which uses only the IRB approach, or a combination of the STC approach and IRB approach, to calculate its credit risk for non-securitization exposures, the institution must–

[15] According to sections 29, 30 and 31 of the BCR, the institution is allowed to deduct from its total risk-weighted amount the portion of its total regulatory reserve for general banking risks and collective provisions apportioned to the STC approach, BSC approach, SEC-ERBA, SEC-SA or SEC-FBA which is not included in Tier 2 capital. Such deductible amount should be reported in item 2.12(i) of Division A of Form MA(BS)3(I).

[16] Please refer to the HKMA's Regulatory Treatment of Expected Loss Provisions under Hong Kong Financial Reporting Standard 9 in Annex II-C.

(i) apportion its regulatory reserve for general banking risks and collective provisions between the STC approach, IRB approach, SEC-IRBA, SEC-ERBA, SEC-SA and SEC-FBA in accordance with section 42(2)(a) or (b) of the BCR, as the case may be. However, the risk-weighted amounts of exposures to CCPs and CVA, if any, are excluded for the operation of paragraph 108; and

(ii) after it has carried out the apportionment referred to in sub-paragraph (i) above –

(a) report its regulatory reserve for general banking risks apportioned to the STC approach, SEC-ERBA, SEC-SA and SEC-FBA (relevant approaches) in item (m) and its collective provisions apportioned to the relevant approaches in item (n);

(b) report the total of items (m) and (n) in item (o) up to an amount not exceeding 1.25% of its aggregate risk-weighted amount for credit risk calculated by using the relevant approaches; and

(c) comply with the instructions in paragraphs 109 and 110 below in respect of that portion of its regulatory reserve for general banking risks and collective provisions apportioned to the IRB approach and SEC-IRBA.

(p) <u>Surplus provisions (for exposures calculated by using IRB approach)</u>

109. For the institution that adopts the IRB approach for credit risk, if its total EL amount is less than its total eligible provisions, the institution may include the amount of the excess of the total eligible provisions over the total EL amount (i.e. the surplus provisions) in its Tier 2 capital up to 0.6% of its risk-weighted amount for <u>credit</u> risk calculated by using the IRB approach (that is to say, the credit RWA should exclude risk-weighted amounts for exposures to CCPs and CVA, if any). The amount to be reported in item (p) of Part II should be consistent with the figure reported in item 9 of Division F of Form MA(BS)3(IIIc).

(q) <u>Regulatory reserve for general banking risks and collective</u>

provisions[17] apportioned to SEC-IRBA

110. An institution falling within paragraph 108 above must report in item (q) that portion of its total regulatory reserve for general banking risks and collective provisions that is apportioned to the SEC-IRBA. The amount reported must not exceed 0.6% of its risk-weighted amount for credit risk calculated by using the SEC-IRBA.

Tier 2 Capital Before Deductions (F)

111. This is the sum of items (j), (k), (l), (o), (p) and (q) in Column 2.

Regulatory deductions from Tier 2 Capital

112. The institution must deduct from its Tier 2 capital in accordance with the provisions set out in Part 3 of the BCR.

With respect to the regulatory deduction of an institution's LAC investments in capital instruments issued by and non-capital LAC liabilities of financial sector entities and capital investments in commercial entities, **Annex II-B** provides an illustration showing the relevant components of different types of LAC investments and loans, facilities or credit exposures that are required to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital under the BCR.

(r)(i) Investments in own Tier 2 capital instruments

113. Report the amount of any direct, indirect and synthetic holdings by the institution of its own Tier 2 capital instruments, unless already derecognized under applicable accounting standards, calculated in accordance with the requirements specified in Schedule 4E of the BCR. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(ii) include in the amount to be deducted under item (r)(i)

[17] Please refer to the HKMA's Regulatory Treatment of Expected Loss Provisions under Hong Kong Financial Reporting Standard 9 in Annex II-C.

potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

(r)(ii) <u>Reciprocal cross holdings in Tier 2 capital instruments issued by and non-capital LAC liabilities of financial sector entities</u>

114. Report the amount of any direct, indirect and synthetic holdings by the institution of Tier 2 capital instruments issued by and non-capital LAC liabilities of financial sector entity where that entity has a reciprocal cross holding with the institution. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(ii) include in the amount to be deducted under item (r)(ii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

(r)(iii) <u>Insignificant LAC investments in Tier 2 capital instruments issued by and non-capital LAC liabilities of financial sector entities that are not subject to consolidation under a section 3C requirement and not covered by either the 5% or the 10% threshold</u>

115. Subject to paragraph 116 below, report the applicable

amount of the institution's direct, indirect and synthetic holdings of Tier 2 capital instruments issued by and non-capital LAC liabilities of financial sector entities, calculated in accordance with Schedule 4F of the BCR, if – (a) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution (or not within the same banking group as the institution in the case of holdings of non-capital LAC liabilities); (b) the holdings are insignificant LAC investments; and (c) the holdings do not otherwise fall within items (r)(i) and (r)(ii) above. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(ii) include in the amount to be deducted under item (r)(iii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

116. The applicable amount to be deducted from the institution's Tier 2 capital under paragraph 115 above should be determined by the formula in the first column of the following table:

Applicable amount	**Reference to Schedule 4F of the BCR**
(For deduction of holdings by an institution that is a "section 2 institution" as defined in section 2 of Schedule 4F to the BCR[18])	
[Excess(10% threshold)(net long) * T2 percentage] + Excess(5% threshold)(gross long)	Sections 1, 2, 4

[18] (Viz., a ***resolution entity*** or ***material subsidiary*** but exclude any material subsidiary that has obtained the MA's prior consent to be treated as a "section 3 institution" (within the meaning of section 3 of Schedule 4F)).

(For deduction of holdings by an institution that is a "section 3 institution" (within the meaning of section 3 of Schedule 4F to the BCR) or treated as such by virtue of section 2(2) of Schedule 4F)	
Excess(10% threshold)(net long) * T2 percentage + Excess(5% threshold)(gross long)	Sections 1, 3, 4

Annex II-D is an illustrative example on how to calculate the applicable amount of insignificant and significant LAC investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

117. The amount of insignificant LAC investments issued by financial sector entities that do not exceed the 10% threshold referred to in paragraph 116 above and therefore not deducted from an institution's Tier 2 capital, is continue to be risk-weighted in accordance with the applicable risk weight under Part 4, 5, 6 or 8 of the BCR, as the case requires.

(r)(iv) Insignificant LAC investments in non-capital LAC liabilities of financial sector entities previously designated for the 5% threshold but no longer able to meet the conditions set out in section 2(3)(a) of Schedule 4F to BCR

118. Item (r)(iv) is applicable only for a "section 2 institution". Report the amount of any holdings in the institution's investments in non-capital LAC liabilities which have previously been designated as gross long deduction position but ceased to be treated as so designated when either or both of the conditions set out in section 2(3)(a) of Schedule 4F to the BCR is or are no longer met in respect of the holdings (i.e. "***Inv(FmDsg NCLAC)***").

119. For avoidance of doubt, the holdings in the institution's investments in non-capital LAC liabilities which have been designated under section 2(3)(a) of Schedule 4F to the BCR must not subsequently be included within the 10% threshold under paragraph 116.

(r)(v) Significant LAC investments in Tier 2 capital instruments issued by financial sector entities that are not subject to consolidation under a section 3C requirement

120. Subject to paragraph 121 below, report the amount of the institution's direct, indirect and synthetic holdings of Tier 2 capital instruments issued by financial sector entities,

calculated in accordance with Schedule 4G of the BCR, if – (a) the entities are not the subject of consolidation under a section 3C requirement imposed on the institution; (b) the holdings are significant LAC investments; and (c) the holdings do not otherwise fall within items (r)(i) and (r)(ii) above. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(ii) include in the amount to be deducted under item (r)(v) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

121. All significant LAC investments in capital instruments issued by financial sector entities that are not in the form of CET1 capital instruments must be fully deducted from an institution's Additional Tier 1 capital and Tier 2 capital, as the case requires, by reference to the tier of capital for which the capital instruments would qualify if they were issued by the institution itself.

Annex II-D is an illustrative example on how to calculate the applicable amount of insignificant and significant LAC investments to be deducted from CET1 capital, Additional Tier 1 capital and Tier 2 capital.

(r)(vi) Significant LAC investments in non-capital LAC liabilities of financial sector entities that are not subject to consolidation under a section 3C requirement

122. Report the amount of the institution's direct, indirect and synthetic holdings of non-capital LAC liabilities of financial sector entities, calculated in accordance with Schedule 4G of the BCR, if – (a) the entities are neither the subject of consolidation under a section 3C requirement imposed on the

institution nor within the same banking group as the institution; (b) the holdings are significant LAC investments; and (c) the holdings do not otherwise fall within item (r)(ii) above.

123. For this purpose, the institution must include in the amount to be deducted under item (r)(vi) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

(r)(vii) <u>Direct holdings of Tier 2 capital instruments issued by financial sector entities that are members of the institution's consolidation group</u>

124. Item (r)(vii) is applicable only for institution who calculates its CAR on a solo/solo-consolidated basis under a section 3C requirement.

125. Report the amount of the institution's direct holdings of Tier 2 capital instruments issued by financial sector entities that are members of the institution's consolidation group. For this purpose, the institution must:

(i) exclude holdings of capital instruments issued by financial sector entities that are not included within regulatory capital in the relevant financial sectors in which those entities operate; and

(ii) include in the amount to be deducted under item (r)(vii) potential future holdings that the institution could be contractually obliged to purchase. In this connection, the HKMA will generally follow the applicable accounting treatment. In case there are areas where the regulatory treatment is different from the accounting treatment, the HKMA will consider each scenario on a case by case basis. The general principle is that if a transaction is subject to conditions precedent which will lead to the institution holding a capital position upon

completion of the transaction where the fulfilment of any of the outstanding conditions is beyond the control of the institution, it may treat the uncompleted transaction as not constituting a potential future holding.

(r)(viii) Regulatory deductions applied to Tier 2 capital to cover the required deductions falling within section 48(1)(g) of BCR

126. For institution that maintains any ***non-capital LAC debt resources***, report the amount by which the total amount of the institution's holdings of non-capital LAC liabilities falling within section 48A of the BCR exceeds the institution's non-capital LAC debt resources. Those holdings of non-capital LAC liabilities that are not deducted from the institution's Tier 2 capital is to continue to be risk-weighted in accordance with the applicable risk-weights under Part 4, 5, 6 or 8, as the case requires.

127. For institution that does not maintain any non-capital LAC debt resources, report the total amount of the institution's holdings of non-capital LAC debt liabilities falling within section 48A of the BCR.

Tier 2 Capital After Deductions **(G)**

128. This is the sum of items (j), (k), (l), (o) (p) and (q) in Column 2 after making the deductions specifically required from Tier 2 capital (i.e. items (r)(i) to (r)(viii)).

129. If the institution's Tier 2 capital before deductions **(F)** is less than the sum of deduction items (r)(i) to (r)(viii), then:

- report "0" in Tier 2 capital after deductions **(G)**; and

- report the sum of items (r)(i) to (r)(viii) minus Tier 2 capital before deductions **(F)** in item (i)(vi).

130. This is also the figure to be reported in item 1.2 of Division A of Form MA(BS)3(I).

Capital Base

Capital Base **(H)**

131. This is the aggregate of Tier 1 capital after deductions **(E)** and Tier 2 capital after deductions **(G)**.

132. This is also the figure to be reported in item 1.3 of Division A of Form MA(BS)3(I).

Hong Kong Monetary Authority
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