



Supervisory Policy Manual

CA-B-3

Countercyclical Capital Buffer (CCyB) – Geographic Allocation of Private Sector Credit Exposures

V. ~~1~~ – 25.09.2015²
[dd.mm.yy]

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.

Purpose

To provide guidance to AIs on determining the geographic allocation of private sector credit exposures¹ for the purposes of implementing the Countercyclical Capital Buffer (CCyB) within the capital adequacy framework for AIs incorporated in Hong Kong.

Classification

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

Previous guidelines superseded

~~This is a new guideline.~~

CA-B-3 “Countercyclical Capital Buffer (CCyB) – Geographical Allocation of Private Sector Credit Exposures” (V.1) dated 25.09.2015.

Application

To all locally incorporated AIs.

Structure

1. Introduction
 - 1.1 Terminology

¹ In this SPM module, the term “private sector credit exposure” has the same meaning as in BCR §3N.



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- 1.2 Background
2. Determining the RWA corresponding to an AI's private sector credit exposures in a jurisdiction (RWA_i)
 - 2.1 Aggregating banking book and trading book private sector credit exposures for each geographic location
 - 2.2 Banking book and trading book exposures for which RWA for credit risk is calculated under the BCR
 - 2.3 Trading book exposures for which an ~~market~~SA-DRC, default risk ~~capital~~ charge ~~for~~or a specific risk charge is calculated under BCR Part 8
3. Determining the geographic location of obligors on an ultimate risk basis

1. Introduction

1.1 Terminology

- 1.1.1 Unless otherwise specified, abbreviations and terms used in this module follow those used in the Banking (Capital) Rules ("BCR") and in the Banking (Disclosure) Rules ("BDR"). In this module, "AI" means "locally incorporated AI" and "BO" means "Banking Ordinance". "AI-specific CCyB" means "CCyB ratio", "JCCyB" means "JCCyB ratio", and "applicable JCCyB" means "applicable JCCyB ratio" as defined respectively in the BCR.

1.2 Background

- 1.2.1 The Basel III regulatory capital standards issued by the Basel Committee provide for the implementation of a CCyB beginning on 1 January 2016.



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- 1.2.2 The MA has made the BCR under BO §97C and the BDR under BO §60A and has, by the Banking (Capital) (Amendment) Rules 2014 and the Banking (Disclosure) (Amendment) Rules 2014, incorporated provisions for the imposition of capital requirements arising from the operation of the CCyB into the BCR and for corresponding disclosures into the BDR, respectively.
- 1.2.3 The MA has ~~issued~~updated SPM module CA-B-1 to provide an overview of the revised CCyB framework in Hong Kong and describe the MA's approach to taking decisions with regard to the setting of the CCyB ~~rates~~ applicable to AIs.
- 1.2.4 As set out in BCR §3O(1) and explained in SPM CA-B-1 section 2, an AI must determine its ~~own~~-AI-specific CCyB ~~rate~~² as the weighted average of the applicable ~~jurisdictional CCyB rates~~JCCyB³, effective at the date for which the determination is made, in respect of the jurisdictions (including Hong Kong) where the AI has private sector credit exposures.⁴ The weight to be attributed to a given jurisdiction's applicable ~~CCyB rate~~JCCyB is the ratio of the AI's aggregate risk-weighted amount for its private sector credit exposures (in both the banking book and the trading book) in that jurisdiction (RWA_i) to the sum of the AI's aggregate RWA_i across all jurisdictions in which the AI has private sector credit exposure.
- 1.2.5 According to BCR §3O(2), the jurisdiction in which an AI is considered to have private sector credit exposures must be determined by the AI, where possible, on an ultimate

² The term "AI-specific CCyB ~~rate~~" corresponds to the term "CCyB ratio" as defined by formula 1A in BCR §3O(1).

³ The ~~terms "applicable jurisdictional CCyB rate" and "jurisdiction's applicable CCyB rate"~~ correspond to the term "applicable JCCyB" corresponds to the term "applicable JCCyB ratio" as defined in BCR §3N.

⁴ As defined in BCR §3N, "private sector credit exposures" exclude exposures to banks regardless of whether the latter are under public sector or private sector ownership.



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risk basis. That is, private sector credit exposures must be allocated to the jurisdiction where the risk ultimately lies to the best of the AI's knowledge and information (see BCR §3N). If it is not possible for an AI to determine the jurisdiction in which the AI has private sector credit exposures on an ultimate risk basis, such exposures are to be allocated to the jurisdiction where the exposures are booked (see BCR §3O(3)).

- 1.2.6 This module sets out the MA's expectations on how an AI should allocate private sector credit exposures, and the corresponding risk-weighted amount (RWA), to different jurisdictions on an ultimate risk basis in accordance with the provisions in the BCR ~~mentioned above~~, in order to determine the AI's aggregate RWA_j for its private sector credit exposures in both the banking book and the trading book in each jurisdiction.

2. Determining the RWA corresponding to an AI's private sector credit exposures in a jurisdiction (RWA_j)

2.1 Aggregating banking book and trading book private sector credit exposures for each geographic location

- 2.1.1 As set out in BCR §3O(1), the aggregate RWA_j of an AI's private sector credit exposures in jurisdiction j for the purposes of calculating the weight to be attributed to that jurisdiction's applicable ~~CCyB rate~~JCCyB (see paragraph 1.2.4 above) is the sum of the following two components:

- (1) *Banking book and trading book exposures for which RWA for credit risk is calculated under the BCR* – this includes the following RWA corresponding to the AI's private sector credit exposures in jurisdiction j –
 - i) the RWA for non-securitisation exposures calculated under the standardised (credit risk) (STC) approach (BCR Part 4), or under the



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basic (BSC) approach (BCR Part 5), or under the ~~IRB~~internal ratings-based (IRB) approach (BCR Part 6), or

- ii) the RWA for counterparty credit risk exposures to central counterparties (CCPs) under BCR Part 6A, Division 4; and
- iii) the RWA for securitisation exposures calculated under BCR Part 7;

as the case requires; and

- (2) *Trading book exposures for which a market risk capital charge ~~for specific risk~~ is calculated under BCR Part 8* – this includes the RWA corresponding to the AI's trading book private sector credit exposures in jurisdiction j derived by multiplying by 12.5 (i) the aggregate of the market risk capital charge for specific risk for those exposures calculated in accordance with BCR Part 8, market risk capital charge for the standardised default risk charge (SA-DRC) under the standardised (market risk) (STM) approach (under BCR Part 8, Division 1D) or (ii) the default risk charge under the internal models approach (IMA) (under BCR Part 8, Division 13 and Schedule 3, Section 2) or (iii) for specific risk under the simplified standardised approach (SSTM approach) (under BCR Part 8, Division 2), as the case requires.

2.1.2 Als are expected to calculate the above two RWA_j components as described, respectively, in subsections 2.2 and 2.3 of this module.

2.1.3 For avoidance of doubt, Als should use the RWA for respective risks calculated in accordance with the specified Parts as stated in the BCR regardless of whether the output floor (under BCR Part 11) is binding or not. Similarly, Als are not required to include RWA for CVA risk



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(under BCR Part 8A) when calculating the above two RWA_i components.

2.2 Banking book and trading book exposures for which RWA for credit risk is calculated under the BCR

2.2.1 **General approach:** An AI should first determine the geographic location of its banking book and trading book exposures for which credit risk RWA is calculated under the BCR (see paragraph 2.1.1(1) above) by identifying in which jurisdiction the obligor(s)⁵ corresponding to each exposure is/are located (if possible on an ultimate risk basis as described in section 3 below). In the case of collective investment schemes (CISs), securitisation exposures and pools of retail exposures under the IRB approach, if all obligors of the respective underlying exposures are located in the same jurisdiction, that jurisdiction should be used as the geographic location of the exposure. For each identified jurisdiction, the AI should then aggregate the RWA of all exposures whose obligors are located in that jurisdiction.

2.2.2 **Special cases:** The following approaches should be applied for determining the geographic location of exposures in the listed special cases:

(1) *Exposure to a CIS:*

- (a) If the obligors of the underlying exposures of the CIS are located in multiple jurisdictions, the jurisdiction for which obligors represent in aggregate the highest proportion of the underlying exposures, as compared with the respective proportion for other jurisdictions, should be used as the geographic location of the

⁵ The obligor in this case is the natural or legal person who is the AI's counterparty to a credit exposure, or the issuer of a financial instrument not included in the trading book, or the counterparty to any other non-trading book exposure (see also definition of "obligor" in the BCR).



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exposure to the respective CIS, subject to the said proportion being at least 30%. In other words, a form of “look through” approach should be applied to determine where the risk of the CIS is predominantly located.

- (b) If however no jurisdiction reaches the above 30% threshold or it is not possible to identify without disproportionate effort a single jurisdiction for which obligors represent the highest proportion of the underlying exposures, the RWA corresponding to the exposure to the respective CIS should be allocated among jurisdictions in the same proportions as the aggregate of the AI's other exposures have been directly allocated to identified geographic locations. So, for instance, if the AI's other exposures have been directly allocated 20% to jurisdiction A, 30% to jurisdiction B and 50% to jurisdiction C, the exposure to the CIS will be allocated on the same 20-/30-/50 split to jurisdictions A, B and C.
- (2) *Securitisation exposure*: The geographic location of a securitisation exposure in either the banking book or the trading book should be determined in the same way as for an exposure to a CIS (see above).
- (3) *Pool of retail exposures under the IRB approach*: If the pool contains exposures located in more than one jurisdiction, then an AI is expected to divide exposures into sub-pools, one for each jurisdiction in which the respective obligors are located. The AI should then determine the RWA of each sub-pool based on the internal model(s) and methodologies rating systems for which the AI has the MA's approval to calculate credit risk for its retail exposures using the IRB approach. If however it is not possible to follow this method without disproportionate effort, the AI should determine the RWA of each sub-pool by multiplying



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the total RWA of the pool by the following ratio: (sub-total of EAD in the sub-pool corresponding to exposures in the given jurisdiction) / (total EAD in the pool).

- (4) *Specialised lending*: The geographic location of the exposure should be the location of the specific physical assets which generates the income that is the primary source of repayment of the obligation, except in the case of commodities and movable physical assets (e.g. ships and aircraft). In the latter case, the general approach of paragraph 2.2.1 (subject to section 3) should prevail.

2.3 Trading book exposures for which an ~~market~~SA-DRC, default risk ~~capital~~-charge ~~for~~or a specific risk ~~charge~~ is calculated under BCR Part 8

2.3.1 *Determining the RWA corresponding to an AI's trading book private sector credit exposures in a jurisdiction* (see BCR §3O(1)): An AI should first identify in which jurisdiction the obligors⁶ are located (if possible on an ultimate risk basis as described in section 3 below) (i) in respect of the AI's ~~interest-rate exposures (non-securitization and securitization⁷) and equity exposures which are subject to a market~~SA-DRC, default risk ~~capital~~ charge ~~for~~or specific risk ~~charge~~; under the STM approach, (ii) the IMA or (iii) the SSTM approach, respectively.⁸ Then, the AI should proceed as follows, depending on ~~whether~~ the ~~approaches that an~~ AI ~~uses to~~ calculates ~~its~~ a-market

⁶ The obligor in this case is the natural or legal person who is the issuer of a financial instrument booked in the trading book, or the counterparty to any other trading book exposure (see also definition of "obligor" in the BCR).

⁷ ~~The geographic location of securitisation exposures in the trading book should be determined as set out in para. 2.2.2(2) above.~~

⁸ See paragraph 2.2.2(2) above regarding how the geographic location of securitisation exposures in the trading book should be determined.



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risk RWA ~~based on the standardized (market risk) approach (STM approach) or on the internal models approach (IMM approach):~~

- (1) *STM approach*: The RWA for the SA-DRC calculated using the STM approach under the BCR for each exposure should be allocated to the jurisdiction in which the obligors associated with the exposure are located.
- (2) ~~IMM approach~~IMA: Solely for the purposes of calculating its AI-specific CCyB ~~rate~~, the AI should divide its relevant exposures into sub-portfolios, one for each jurisdiction in which the respective obligors are located. The AI should then apply to each sub-portfolio the same ~~IMM approach~~IMA methodology which the AI uses to calculate its ~~market default risk capital charge for specific risk (including as applicable components corresponding to: VaR, stressed VaR, incremental risk charge (IRC), comprehensive risk charge (CRC) and supplemental capital charge (SCC) for a correlation trading portfolio)~~, to compute a sub-portfolio ~~market portfolio's default risk capital charge for specific risk~~ portfolio's default risk charge (i.e. the ~~market default risk capital charge for specific risk~~ market default risk charge multiplied by 12.5) calculated for all the relevant exposures of the AI under the ~~IMM approach~~IMA should then be allocated on a pro rata basis to each jurisdiction based on the sub-portfolio ~~market risk capital charges for specific risk portfolios' ones~~.
- (3) *SSTM approach*: The RWA for specific risk calculated using the SSTM approach under the BCR for each exposure should be allocated to the jurisdiction in which the obligors associated with the exposure are located.

Notwithstanding the above, AIs which have been exempted by the MA from market risk calculation under



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BCR §22(1) will be considered as not having exposures subject to a market risk capital charge for (i) ~~specific risk~~ the SA-DRC, default risk charge, or specific risk under the STM approach, (ii) the IMA or (iii) the SSTM approach, respectively, for the above purposes (see BCR §30(1)).

3. Determining the geographic location of obligors on an ultimate risk basis

3.1.1 **Ultimate risk basis:** As set out in BCR §30(2) and §3N (see paragraph 1.2.5 above), the jurisdiction in which an AI is considered to have private sector credit exposure should be determined by the AI, where possible, on an “ultimate risk basis”. “Ultimate risk basis” means the allocation of exposures to the jurisdiction where the risk ultimately lies, defined as the location where the “ultimate obligor” resides. AIs should apply the following guidelines to implement this principle.

3.1.2 **Immediate ~~obligor~~ counterparty:** The location of an immediate ~~obligor~~ counterparty⁹ in respect of an exposure is the jurisdiction where the counterparty in the corresponding contract or the issuer of the corresponding security is ordinarily resident (in the case of a natural person), or has its registered office (or its actual centre of administration if that is in a different jurisdiction from its registered office) (in the case of a legal person). The location of the immediate ~~obligor~~ counterparty should be used as the location of the ~~obligor~~ counterparty for the purposes of subsections 2.1 and 2.2 above unless, in the circumstances referred to in paragraph 3.1.3 below, an ultimate obligor’s location should be used instead. If neither the location of the ultimate obligor nor that of the immediate ~~obligor~~ counterparty can be determined without

⁹ The term “immediate counterparty” is also used in the Completion Instructions for MA(BS)21 [or MA(BS)29 if MA(BS)21 is replaced in future].



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disproportionate effort, the exposure should be allocated to the jurisdiction where it is booked.

3.1.3 **Ultimate obligor:** The location of the ultimate obligor should be used for the purposes of subsections 2.1 and 2.2 above when it differs from that of the immediate ~~obligor~~counterparty in the circumstances specified in the completion instructions for MA(BS)21~~[or MA(BS)29]~~ “Return of International Banking Statistics”.¹⁰ In addition to the cases contemplated in the completion instructions for MA(BS)21~~[or MA(BS)29]~~, Als are expected to apply the following guidelines in determining the ultimate obligor or the location of the ultimate obligor:¹¹

- (1) In line with the Completion Instructions for MA(BS)21~~[or MA(BS)29]~~, to the extent that credit risk has been mitigated by means of a recognised guarantee or a recognised credit derivative contract, the ultimate obligor of the credit protection covered portion of the exposure is the credit protection provider under the recognised guarantee or the recognised credit derivative contract. The RWA of the credit protection covered portion is then allocated to the jurisdiction where the ultimate obligor is located. The credit protection covered portion of the exposure is a private sector credit exposure only if the credit protection provider is a private obligor as defined in BCR §3N.
- (2) To the extent that credit risk has been mitigated by means of the posting of recognised collateral, the following cases should be considered in determining the geographic location of the ultimate risk:
 - (a) For the simple approach under the STC approach (as provided for under BCR Part 4, Division 6) or

¹⁰ ~~As of the date of issue of For this SPM module, the relevant text is contained in para-purpose. Als should refer to paragraph~~ 26 of the completion instructions for MA(BS)21~~[or MA(BS)29]~~.

¹¹ Future revisions to the completion instructions for MA(BS)21 will have precedence over the following provisions in this SPM module in case of any contradiction.



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under the BSC approach (as provided for under BCR Part 5, Division 5), AIs should allocate the RWA of the credit protection covered portion to the jurisdiction where the recognised collateral, or the issuer/obligor of the recognised collateral, is located, subject to (c), (d), ~~(e)~~ and ~~(fe)~~ below.

- (b) For the comprehensive approach under the STC approach and for the IRB approach, the location of the collateral or of the issuer/obligor of the collateral (or of the underlying exposures of the collateral) is deemed irrelevant for purposes of the CCyB ~~ratio~~ calculation.

~~(c) Where the recognized collateral is in the form of real property, the geographic location of the collateral is the jurisdiction where the collateral is physically located.~~

~~(d)~~(c) Where the recognised collateral is in the form of securities which are neither credit-linked notes nor securitisation issues, (subject to ~~(fe)~~) the geographic location of the collateral is the jurisdiction where the issuer of the securities resides.

~~(e)~~(d) Where the recognised collateral is in the form of shares or units in a CIS or securities in a securitisation issue, the geographic location of the collateral is determined as per paragraph 2.2.2(1) above.

~~(f)~~(e) Where the recognised collateral is in the form of cash on deposit held at a bank, gold bullion or where the collateral is in the form of securities and the issuer/obligor of the securities is not a private obligor as defined in BCR §3N, the credit protection covered portion of the exposure is not a private sector credit exposure for CCyB purposes and therefore its RWA should not be considered as part of RWA_j for the purposes of BCR §3O(1).



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- (3) In circumstances where, in the HKMA's judgement, exposures booked in a jurisdiction and/or to obligors /counterparties residing in that jurisdiction (whether an off-shore financial centre or otherwise) typically do not appear to have an economic nexus with that jurisdiction or it appears unlikely that much of the proceeds will actually be used in that jurisdiction, and where the jurisdiction in question has not implemented, and does not operate, a Basel III CCyB framework, the HKMA may notify AIs and post on its website a specific list of such jurisdictions. If the MA does so, an AI's private sector credit exposures booked in those jurisdictions and/or to obligors residing in those jurisdictions should be allocated to Hong Kong for the purposes of calculating its AI-specific CCyB—~~rate~~, unless on a case-by-case basis the AI can present evidence acceptable to the HKMA that an exposure indeed has a genuine nexus with such jurisdictions.

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