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LEGISLATIVE COUNCIL BRIEF

BANKING ORDINANCE
(Cap. 155)

Banking (Capital) (Amendment) Rules 2020

INTRODUCTION

For the purpose of implementing the latest international standards on banking regulation promulgated by the Basel Committee on Banking Supervision ("Basel Committee"), the Monetary Authority has made the Banking (Capital) (Amendment) Rules 2020 ("BCAR"), at **Annex**, under section 97C of the Banking Ordinance (Cap. 155) to provide for –

(a) a new method for calculating an authorized institution's[1] exposure amount of counterparty credit risk arising from derivative contracts, as set out in the document entitled *"The standardised approach for measuring counterparty credit risk exposures"* published by the Basel Committee in March 2014 (and revised in April 2014); and

(b) the revised capital treatment of an authorized institution's default fund contributions and exposures in respect of access to central clearing services for derivatives contracts through multiple layers of intermediaries, as set out in the document entitled *"Capital requirements for bank exposures to central counterparties"* published by the Basel Committee in April 2014.

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[1] Under the Banking Ordinance, an "authorized institution" refers to a bank, a restricted licence bank or a deposit-taking company licensed under the Ordinance.

JUSTIFICATIONS

2. The Basel Committee is an international body responsible for setting standards on banking regulation. In the aftermath of the global financial crisis in 2007-08, the Basel Committee has introduced sweeping regulatory reforms aimed at enhancing the resilience of banks against future shocks. Jurisdictions across the globe are required to implement more rigorous standards covering capital, liquidity, disclosure, exposure limits and other requirements for banks. The two sets of revised Basel standards governing the treatment of banks' counterparty credit risk exposures to derivatives trades, as set out in the Basel Committee's publications named in paragraph 1 above, form an important part of the Basel III reform package to ensure the capital adequacy of banks. Complementing the global over-the-counter derivatives market reforms to promote central clearing of derivatives trades, the Basel standards are designed to better address the relevant risks observed in stress periods and reflect the prevailing risk management practices of banks.

3. As a member of the Basel Committee, it is incumbent upon Hong Kong to implement the international standards promulgated by the Basel Committee. It is therefore necessary to amend the Banking (Capital) Rules (Cap. 155L; hereafter referred to as the "principal Rules"), which prescribe a capital adequacy framework for banks in accordance with the Basel standards, to implement the two sets of revised Basel standards for managing credit risks arising from counterparty default of a bank's derivatives portfolios. This will ensure the stability of our banking system and underline our status as an international financial centre that takes its international obligations seriously.

The Standardised Approach for Measuring Counterparty Credit Risk Exposures ("SA-CCR")

4. In accordance with "*The standardised approach for measuring counterparty credit risk exposures*" promulgated by the Basel Committee, the BCAR seek to introduce a new method, namely the "standardized (counterparty credit risk) approach" ("SA-CCR approach"), for calculating an authorized institution's exposure amount of counterparty credit risk arising from derivatives contracts. The SA-CCR approach will replace

the "current exposure method" ("CEM") presently used by banks, which has been criticised for its limitations, including that there is no differentiation between margined and unmargined transactions, the supervisory add-on factors fail to reflect the level of volatilities observed during recent stress periods, and that the manner in which netting benefits are recognised is not reflective of the economically meaningful relationship between derivatives positions. The SA-CCR approach provides a more robust method for measuring a bank's risk exposures arising from derivative contracts entered into with counterparties in a way that better reflects the margining effects and the netting benefits. Compared with the CEM, the SA-CCR approach is more risk-sensitive, with various risk parameters in the calculation methodology recalibrated to reflect market volatilities observed during the global financial crisis. It also provides more meaningful recognition of credit risk mitigation techniques (e.g. variation margin) that are more reflective of the risk management practices in the market.

Capital Requirements for Bank Exposures to Central Counterparties ("CCP Standard")

5. The BCAR also seek to revise the capital treatment of an authorized institution's exposures arising from derivatives transactions cleared by central counterparties according to the Basel Committee's promulgation in the *"Capital requirements for bank exposures to central counterparties"*. The existing method in the principal Rules for calculating the capital requirements of an authorized institution's exposures arising from its contribution to the default fund of a qualifying central counterparty ("QCCP")[2] will be replaced by a new methodology under which the SA-CCR approach will be used to determine a QCCP's counterparty credit risk exposures to its clearing members. This apart, a cap will be set on an authorized institution's total capital charges for its exposures to a QCCP, and a multi-level client structure will be introduced with capital treatments of exposures between clients within the structure

[2] QCCPs are central clearing houses of over-the-counter derivatives contracts subject to prudential supervision by competent regulators. In recognition of this fact, banks' exposures to QCCPs are allowed more preferential capital treatment than those to other clearing houses. A bank may utilise a QCCP for clearing derivatives contracts by directly becoming a member of the clearing house, or it may clear its derivatives contracts at the QCCP indirectly through intermediaries. Default fund is a mutualised loss-sharing arrangement contributed by members, under which non-defaulting clearing members may be required to share losses due to a default of another clearing member.

clearly laid down in the principal Rules. Working together, the revised standards aim to ensure that there are incentives for banks to mitigate the counterparty credit risks arising from bilateral transactions by adopting central clearing services for derivatives contracts, and that banks handle their exposures to central counterparties in a risk-sensitive manner.

6. The opportunity is taken to introduce miscellaneous amendments, which are all technical in nature, to enhance clarity of certain existing provisions in the principal Rules. Such primarily include amendments to refine the capital treatment under the securitisation framework to reflect certain common practices relating to the origination of securitisation transactions.

THE SUBSIDIARY LEGISLATION

7. The key amendments proposed in the BCAR are as follows –

SA-CCR

(a) Sections 10A, 10B, 10C and 10D – Revisions are made such that an authorized institution must use SA-CCR to measure its counterparty credit risk exposure, unless it is one that currently uses the "basic approach"[3] for calculating credit risk capital requirement, in which case it may use a modified CEM[4] instead of SA-CCR;

(b) Parts 4, 5 and 6 – Existing provisions related to CEM are repealed. Corresponding new provisions related to SA-CCR, together with other provisions relating to the measurement of counterparty credit risk exposure arising from securities financing transactions[5],

[3] The "basic approach" is one of the three approaches prescribed in the principal Rules for risk-weighting an authorized institution's credit exposures.

[4] Intended for use by smaller authorized institutions with limited scale of operations, the modified CEM follows the design of the existing CEM but is updated with certain modifications in risk parameters to align with those in the SA-CCR.

[5] Securities financing transactions refer to repo, reverse repo and securities lending/borrowing transactions.

are relocated to Part 6A (Calculation of Counterparty Credit Risk), for the purpose of consolidating under Part 6A provisions in the principal Rules relating to the capital treatment of CCR exposures;

(c) New Divisions 1A, 2A and 2B of Part 6A – The new divisions set out respectively SA-CCR, modified CEM and the provisions related to securities financing transactions relocated from other parts of the principal Rules;

CCP Standard

(d) Division 4 of Part 6A – Some of the existing provisions in sections 226X and 226Y are superseded by new provisions to prescribe the new capital treatment for default fund contributions made to QCCPs. New provisions are also inserted to set out the capital treatment for exposures between clients within a multi-level client structure;

(e) New Schedule 16 – The new schedule provides for a transitional arrangement for authorized institutions to treat existing QCCPs in jurisdictions which have yet to implement SA-CCR[6] as QCCPs under the revised Division 4 of Part 6A for risk-weighting purposes; and

Others

(f) Section 230 and Schedule 10 – Revisions are made to specify (i) the conditions that must be met in order for unfunded credit protection provided by a special purpose vehicle in a securitisation transaction to be recognised to mitigate credit risk; and (ii) how the credit protection should be taken into account in

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[6] Under the CCP Standard, a clearing house can be regarded as a QCCP (hence subject to more preferential capital treatment) only if it can provide certain data relating to its counterparty credit risk exposures to clearing members measured based on the SA-CCR approach. The transitional arrangement is in line with that adopted in major jurisdictions for accommodating time differences among jurisdictions in implementing SA-CCR.

calculating the capital requirement for assets securitised through the transaction.

LEGISLATIVE TIMETABLE

8. The subsidiary legislation will be published in the Gazette on 24 April 2020 and tabled before the Legislative Council ("LegCo") at its sitting of 29 April 2020. Subject to negative vetting by LegCo, the BCAR will come into operation on 30 June 2021.[7]

IMPLICATIONS OF THE PROPOSALS

9. The amendments proposed in the BCAR are intended to bring the regulatory regime in Hong Kong up-to-date and in line with international standards. They will further enhance the resilience of banks, thereby contributing to the overall stability of the banking system.

10. The BCAR are in conformity with the Basic Law, including the provisions concerning human rights. The proposed amendments will not affect the current binding effect of the Banking Ordinance.

PUBLIC CONSULTATION

11. At the meeting of the LegCo Panel on Financial Affairs ("FA Panel") on 23 May 2016, the Hong Kong Monetary Authority ("HKMA") briefed members on the key features of the SA-CCR and the CCP Standard. Further updates on the implementation progress of the two Basel standards were provided to the FA Panel at its meetings in May 2019 and March 2020.

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[7] Originally scheduled to take effect internationally on 1 January 2017, implementation of the SA-CCR and the CCP Standard has been deferred in some major jurisdictions (including Singapore, the United States and the European Union) in order to accommodate local circumstances. To facilitate cross-border harmonisation and ensure a level-playing field for authorized institutions in Hong Kong vis-à-vis their overseas counterparts on the adoption of these standards, the implementation date for Hong Kong has likewise been deferred to 30 June 2021 to align with the implementation timelines in these jurisdictions.

12. HKMA has closely engaged the banking industry in the course of formulating the legislative amendments, through industry consultations conducted in October 2015 and August 2018, and statutory consultation conducted in March 2020 pursuant to the Banking Ordinance.[8] The BCAR have taken into consideration comments received from the banking community on the policy proposals and the draft provisions, with adjustments made as appropriate.

PUBLICITY

13. We will issue a press release upon gazettal of the BCAR. HKMA will also issue a circular letter to all authorized institutions.

ENQUIRIES

14. For enquiries, please contact Ms Eureka Cheung, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), at 2810 2067, or Mr Richard Chu, Head (Banking Policy) of HKMA, at 2878 8276.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
22 April 2020

[8] Pursuant to the Banking Ordinance, parties included in the statutory consultation cover the Banking Advisory Committee, the Deposit-taking Companies Advisory Committee, the Hong Kong Association of Banks and the DTC Association.

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Banking (Capital) (Amendment) Rules 2020

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Banking (Capital) (Amendment) Rules 2020

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1. Commencement

These Rules come into operation on 30 June 2021.

2. Banking (Capital) Rules amended

The Banking (Capital) Rules (Cap. 155 sub. leg. L) are amended as set out in sections 3 to 116.

3. Section 2 amended (interpretation)

(1) Section 2(1)—

Repeal the definition of *CCP-related transaction*

Substitute

"***CCP-related transaction*** (CCP 關聯交易)—see section 2AA;".

(2) Section 2(1), definition of ***CEM risk-weighted amount***, paragraph (a)—

Repeal

"if the STC approach or BSC approach is used".

(3) Section 2(1), definition of ***CEM risk-weighted amount***, paragraph (b)—

Repeal

"under the STC approach, BSC approach or IRB approach, as the case requires"

Substitute

"by using the BSC approach".

(4) Section 2(1)—

Repeal the definition of *commodity*

Substitute

"***commodity*** (商品)—

(a) in relation to the calculation of counterparty credit risk, means any of the following—

(i) any metal (including gold), energy, agricultural product or any other physical product;

(ii) any freight rate, climatic variable or other economic statistic (other than any measure of inflation); or

(b) in any other case—means any precious metal (other than gold), base metal, non-precious metal, energy, agricultural asset or other physical product that is traded on an exchange;".

(5) Section 2(1)—

Repeal the definition of *credit conversion factor*

Substitute

"***credit conversion factor*** (信貸換算因數)—

(a) in relation to the determination of the credit equivalent amount (within the meaning of section 51(1), 105 or 139(1) as the case requires) of an off-balance sheet exposure of an authorized institution that is not a default risk exposure—means a percentage by which the principal amount (within the meaning of section 51(1), 105 or 139(1) as the case requires) of the exposure is multiplied as a part

of the process for determining the credit equivalent amount of the exposure; or

(b) in relation to the determination of the amount of default risk exposure in respect of a derivative contract by using the current exposure method—means a percentage by which the notional amount of the derivative contract is multiplied as a part of the process for determining the amount of the exposure;".

(6) Section 2(1), definition of ***credit quality grade***—

Repeal

"for determining the appropriate risk-weight for an exposure of an authorized institution"

Substitute

"in accordance with Schedule 11 or 14 to the pre-amended Rules (within the meaning of section 287A) or Schedule 6, 8 or 11".

(7) Section 2(1)—

Repeal the definition of *current exposure*

Substitute

"***current exposure*** (現行風險承擔), in relation to a derivative contract of an entity (***existing contract***), means the replacement cost that—

(a) would be incurred by the entity if it were required to enter into another derivative contract to replace the existing contract with another counterparty with substantially the same economic consequences for the entity; and

(b) is calculated by marking-to-market the existing contract, and—

(i) if the resultant value is positive for the entity—taking the resultant value of the contract; or

(ii) if the resultant value is zero or negative for the entity—taking the value of zero;".

(8) Section 2(1)—

Repeal the definition of *current exposure method*

Substitute

"***current exposure method*** (現行風險承擔方法) means the method of calculating default risk exposures in respect of derivative contracts set out in Division 2A of Part 6A;".

(9) Section 2(1)—

Repeal the definition of *default risk exposure*

Substitute

"***default risk exposure*** (違責風險的風險承擔), in relation to derivative contracts or SFTs entered into with a counterparty (***relevant trades***), means an exposure to the counterparty default risk of the counterparty in respect of the relevant trades the amount of which is calculated by using—

(a) the SA-CCR approach;

(b) the IMM(CCR) approach;

(c) the current exposure method; or

(d) any of the methods set out in Division 2B of Part 6A;".

(10) Section 2(1), definition of ***effective expected positive exposure***—

Repeal

"or 226L, as the case requires".

(11) Section 2(1), definition of ***exchange rate contract***, paragraph (a)—

Repeal

"including"

Substitute

"excluding".

(12) Section 2(1)—

Repeal the definition of *haircut*

Substitute

"***haircut*** (扣減) means an adjustment to be applied to a credit protection or an exposure to take into account volatilities in value or exchange rates;".

(13) Section 2(1), definition of ***long settlement transaction***, paragraph (b)—

Repeal

"institution"

Substitute

"counterparty".

(14) Section 2(1), definition of ***margin lending transaction***, paragraph (a)—

Repeal

"the institution extends credit"

Substitute

"credit is extended".

(15) Section 2(1)—

Repeal the definition of *minimum holding period*

Substitute

"***minimum holding period*** (最短持有期), in relation to a collateral or any other thing held by an authorized institution, or by another person, for the institution's benefit (however described), means a period—

(a) that is reasonably likely to be required by the institution to realize the collateral or thing;

(b) that commences on the date of the default by the obligor giving rise to the right on the part of the institution to realize the collateral or thing; and

(c) that ends on the business day (being a day that is not a public holiday in any relevant market for the collateral or thing) on which the institution would be reasonably likely to be able to realize the collateral or thing;".

(16) Section 2(1)—

Repeal the definition of *netting set*

Substitute

"***netting set*** (淨額計算組合)—

(a) in relation to the calculation of the default risk exposure by using a method or approach other than the IMM(CCR) approach, means—

(i) a group of transactions with a counterparty that are subject to recognized netting; or

(ii) a transaction with a counterparty that is not subject to recognized netting or that is treated as if it were not subject to recognized netting; or

(b) in relation to the calculation of the default risk exposure by using the IMM(CCR) approach, means—

(i) a transaction falling within section 226J(1);

(ii) a group of transactions with a counterparty (other than a transaction falling within section 226J(1)) that are subject to recognized netting; or

(iii) a transaction with a counterparty (other than a transaction falling within section 226J(1)) that is not subject to recognized netting or that is treated as if it were not subject to recognized netting;".

(17) Section 2(1), definition of ***notional amount***—

Repeal

"of an authorized institution".

(18) Section 2(1), definition of ***outstanding default risk exposure***—

Repeal

"OTC derivative transaction or credit".

(19) Section 2(1), definition of ***over-the-counter derivative transaction***—

Repeal

"(other than a credit derivative contract)".

(20) Section 2(1), definition of ***recognized credit risk mitigation***, paragraph (e)—

Repeal

"that falls within section 226H(3)"

Substitute

"received by the institution that may be included in the calculation mentioned in section 226BJ(1), (2) or (3) or the estimation mentioned in section 226H(2)(a)".

(21) Section 2(1), definition of ***reference entity***—

Repeal

"a credit"

Substitute

"a credit-related".

(22) Section 2(1), definition of ***repo-style transaction***—

Repeal

", in relation to an authorized institution, means a transaction entered into by the institution whereby the institution"

Substitute

"means a transaction entered into by a person whereby the person".

(23) Section 2(1)—

Repeal the definition of *standard supervisory haircut*

Substitute

"***standard supervisory haircut*** (標準監管扣減) means a haircut set out in the Table in section 1 of Schedule 7;".

(24) Section 2(1)—

(a) definition of ***client***;

(b) definition of ***debt security contract***;

(c) definition of ***equity contract***;

(d) definition of ***other commodity contract***;

(e) definition of ***potential exposure***;

(f) definition of ***precious metal contract***;

(g) definition of ***shortcut method***—

Repeal the definitions.

(25) Section 2(1)—

Add in alphabetical order

"*clearing client* (結算客户)—see section 2AA;

clearing intermediary (結算中介人)—see section 2AA;

client within a multi-level client structure (多層客户結構內的客户)—see section 2AA;

clients at levels higher than the institution (階級高於該機構的客户)—see section 2AA;

credit-related derivative contract (信用關聯衍生工具合約) means—

(a) a credit derivative contract; or

(b) a derivative contract (other than a credit derivative contract) where—

(i) the value of the contract is primarily driven by the credit risk of, or any change in the credit risk of, one or more than one underlying asset or financial instrument designated in the contract; and

(ii) the credit risk or the change may be measured in terms of one or more than one index or indicator of credit risk;

direct client (直接客户)—see section 2AA;

end client (最終客户)—see section 2AA;

higher level client (高階客户)—see section 2AA;

indirect client (間接客户)—see section 2AA;

inflation derivative contract (通脹衍生工具合約) means a derivative contract the value of which changes in response to changes in one or more measures of inflation;

lower level client (低階客户)—see section 2AA;

multi-level client structure (多層客户結構)—see section 2AA;

offsetting transaction (抵銷交易)—see section 2AA;

SA-CCR approach (SA-CCR 計算法) means the standardized (counterparty credit risk) approach;

SA-CCR risk-weighted amount (SA-CCR 風險加權數額), in relation to derivative contracts entered into by an authorized institution, means the sum of the default risk risk-weighted amounts for all the counterparties to the contracts where the default risk risk-weighted amount for each of the counterparties is calculated as the product of—

(a) the outstanding default risk exposure (net of specific provisions if the STC approach or BSC approach is used) to the counterparty calculated by using the SA-CCR approach; and

(b) the risk-weight applicable to the outstanding default risk exposure determined by using the STC approach, BSC approach or IRB approach, as the case requires;

standardized (counterparty credit risk) approach (標準(對手方信用風險)計算法) means the method of calculating default risk exposures in respect of derivative contracts set out in Division 1A of Part 6A;

unsegregated collateral (無隔離抵押品), in relation to an authorized institution, means collateral that—

(a) is posted by the institution for—

(i) its transaction that is cleared by a CCP; or

(ii) a bilateral transaction entered into by the institution with a counterparty; and

(b) is not held on a bankruptcy remote basis;".

4. Section 2AA added

After section 2—

Add

"2AA. Interpretation: certain terms involving CCP and clients etc.

(1) In these Rules—

clearing intermediary (結算中介人), in relation to a CCP, means a party (including a clearing member of the CCP) who has a contractual relationship with another party (***clearing client***) that enables the clearing client to access the CCP.

(2) If a clearing client of a clearing intermediary in respect of a CCP enters into a transaction with the clearing intermediary in order to access the CCP but the clearing client does not do so for performing the function of a clearing intermediary in respect of the CCP, the clearing client is an end client.

(3) If a clearing intermediary in respect of a CCP is a clearing member of the CCP, the clearing client of the clearing intermediary is a direct client (regardless of whether the clearing client is an end client or not in respect of a transaction entered into with, or guaranteed by, the clearing intermediary). If a clearing intermediary in respect of the CCP is not a clearing member of the CCP, the clearing client of the clearing intermediary is an indirect client.

(4) If a clearing member of a CCP enters into a transaction with the CCP but the clearing member does not do so for performing the function of a clearing intermediary in respect of the CCP, the transaction is a CCP-related transaction.

(5) If a clearing member of a CCP acts on behalf of an end client in the capacity of a clearing intermediary in respect of the CCP—

(a) a transaction between the clearing member and the CCP is an offsetting transaction; and

(b) a transaction between the clearing member and the end client is a CCP-related transaction.

(6) If an end client accesses a CCP through at least 2 clearing intermediaries interposed between the CCP and the end client, then—

(a) all the interposed clearing intermediaries (other than a clearing member of the CCP) and the end client are referred to collectively as a multi-level client structure associated with the CCP and individually as a client within a multi-level client structure;

(b) where an authorized institution as a clearing intermediary within the multi-level client structure associated with the CCP provides clearing services to another clearing intermediary or the end client within the structure, that other clearing intermediary or the end client is a lower level client of the institution;

(c) where an authorized institution as a clearing intermediary or the end client within the multi-level client structure associated with the CCP receives clearing services from another clearing intermediary within the structure—

(i) that other clearing intermediary is a higher level client of the institution; and

(ii) the higher level client and any clearing intermediary within the structure at a level higher than the higher level client are clients at levels higher than the institution;

(d) the following transaction is an offsetting transaction if the transaction is entered into for enabling the end client to access the CCP—

(i) a transaction between the CCP and a clearing member of the CCP;

(ii) a transaction between a clearing member of the CCP and a direct client of the clearing member that is a clearing intermediary within the multi-level client structure associated with the CCP;

(iii) a transaction between an authorized institution and a higher level client or lower level client where both the institution and the client are clearing intermediaries; and

(e) the following transaction is a CCP-related transaction if the transaction is entered into for enabling the end client to access the CCP—

(i) a transaction between an authorized institution that is the end client and a higher level client;

(ii) a transaction between an authorized institution and a lower level client that is the end client.".

5. Section 10A amended (authorized institution must only use current exposure method, etc. to calculate its counterparty credit risk)

(1) Section 10A, heading—

Repeal

"current exposure method,"

Substitute

"SA-CCR approach".

(2) Section 10A(1), after "(2)"—

Add

", (2A)".

(3) Section 10A(1)(a)—

Repeal

"current exposure method"

Substitute

"SA-CCR approach".

(4) Section 10A(1)—

Repeal paragraph (b)

Substitute

"(b) use the methods set out in Division 2B of Part 6A to calculate the institution's default risk exposures in respect of SFTs; and".

(5) Section 10A(1)(c)(i)—

Repeal

"and credit derivative contracts".

(6) After section 10A(2)—

Add

"(2A) An authorized institution may use the current exposure method to calculate its default risk exposures in respect of derivative contracts if it uses the BSC approach to calculate its credit risk for non-securitization exposures.

(2B) Despite subsection (2A), the Monetary Authority may, by written notice given to an authorized institution, require the institution to use the SA-CCR approach to calculate its default risk exposures if the Monetary Authority believes that, taking into account the nature of the institution's business, the use by the institution of the current exposure method would not adequately assess and

reflect the counterparty default risk incurred by the institution.”.

(7) Section 10A(4)(a)—

Repeal

“and credit derivative contracts”.

(8) Section 10A(5)(a)—

Repeal

“current exposure method”

Substitute

“SA-CCR approach”.

(9) Section 10A(7), after “subsection”—

Add

“(2B) or”.

(10) Section 10A(8), after “(2)”—

Add

“, (2A), (2B)”.

6. Section 10B amended (authorized institution may apply for approval to use IMM(CCR) approach to calculate its default risk exposures)

(1) Section 10B(5) and (7)—

Repeal

“current exposure method or the methods referred to in section 10A(1)(b)”

Substitute

“SA-CCR approach or the methods set out in Division 2B of Part 6A”.

(2) Section 10B(9)—

Repeal paragraph (b)

Substitute

“(b) switch to using the SA-CCR approach, the current exposure method or any of the methods set out in Division 2B of Part 6A.”.

7. Section 10C amended (provisions supplementary to prescribed methods for calculation of CVA capital charge)

Section 10C(1)(b) and (c)—

Repeal

“current exposure method or the methods referred to in section 10A(1)(b)”

Substitute

“SA-CCR approach or the methods set out in Division 2B of Part 6A”.

8. Section 10D amended (measures that may be taken by Monetary Authority if authorized institution using IMM(CCR) approach no longer satisfies specified requirements)

Section 10D(2)(a)—

Repeal

“current exposure method or the methods referred to in section 10A(1)(b)”

Substitute

“SA-CCR approach or the methods set out in Division 2B of Part 6A”.

9. Section 15B amended (meaning of *eligible ABCP exposure*)

Section 15B(f), Chinese text—

Repeal

"均由該機關"

Substitute

"，均由該機構".

10. Section 16A amended (authorized institution must use Division 4 of Part 6A to calculate its credit risk for exposures to CCPs, etc.)

Section 16A—

Repeal paragraphs (b) and (c)

Substitute

"(b) its credit risk for exposures to clearing members in respect of CCP-related transactions and offsetting transactions;

(c) its credit risk for exposures to direct clients, or higher level clients or lower level clients within multi-level client structures, in respect of CCP-related transactions and offsetting transactions;

(ca) its credit risk for exposures to direct clients in respect of guarantees of the clients' performance under transactions or contracts cleared by CCPs; and".

11. Section 51 amended (interpretation of Part 4)

(1) Section 51(1), definition of ***credit equivalent amount***—

Repeal

", means the credit equivalent amount of the exposure calculated under section 71"

Substitute

"that is not a default risk exposure, means the credit equivalent amount of the exposure calculated in accordance with section 71(1) or (2)".

(2) Section 51(1), definition of ***principal amount***, paragraph (b)(i), after "Table 10"—

Add

"or to which section 73(2) applies".

(3) Section 51(1), definition of ***principal amount***, paragraph (b)(ii)—

Repeal

"arising"

Substitute

"or to which section 73(2) applies that arises".

(4) Section 51(1), definition of ***principal amount***, paragraph (b)—

Repeal subparagraphs (iii) and (iv)

Substitute

"(iii) subject to subparagraph (iv), in the case of an exposure in respect of a derivative contract, the notional amount of the contract;

(iv) in the case of an exposure in respect of a derivative contract where the stated notional amount of the contract is leveraged or enhanced by the structure of the contract, the effective notional amount of the contract calculated by taking into account the effect of the leverage or enhancement, as the case requires;".

(5) Section 51(1), definition of ***SFT risk-weighted amount***—

Repeal

everything after "calculated as the"

Substitute

"sum of the risk-weighted amounts of the default risk exposures across all the SFTs with the counterparty calculated in accordance with section 76A;".

(6) Section 51(1)—

(a) definition of ***minimum holding period***;

(b) definition of ***non-qualifying reference obligation***;

(c) definition of ***qualifying reference obligation***;

(d) definition of ***standard supervisory haircut***—

Repeal the definitions.

12. Section 52 amended (calculation of risk-weighted amount of exposures)

(1) Section 52(3)(a)—

Repeal

"OTC derivative transactions, credit".

(2) Section 52(3)(a)(iii)—

Repeal

"CEM"

Substitute

"SA-CCR".

(3) Section 52(3)(d)—

Repeal

"OTC derivative transactions, credit".

(4) Section 52(3A)(b)—

Repeal

"CEM"

Substitute

"SA-CCR".

13. Section 53 amended (on-balance sheet exposures and off-balance sheet exposures to be covered)

(1) Section 53(1)(b)(i)—

Repeal

"OTC derivative transactions, credit".

(2) Section 53(1)(b)—

Repeal subparagraph (ii)

Substitute

"(ii) in respect of unsegregated collateral posted by the institution for transactions or contracts booked in its trading book; and".

14. Section 64 amended (regulatory retail exposures)

(1) Section 64(2)(a)(ii)—

Repeal

", credit derivative contract".

(2) Section 64(2)(a)(ii)(A)—

Repeal

"or credit derivative contract".

15. Section 65 amended (residential mortgage loans)

Section 65(6)(b)(ii)—

Repeal

"by an insurance firm which has an attributed risk-weight of not more than 20%; or"

Substitute

"by—

(A) the HKMC Insurance Limited; or

(B) an insurance firm that has an attributed risk-weight of not more than 20%; or".

16. Section 70A repealed (application of sections 71(2) and (3), 72 and 73(b) and (c))

Section 70A—

Repeal the section.

17. Section 71 amended (off-balance sheet exposures)

(1) Section 71(1), after "an off-balance sheet exposure"—

Add

"(other than default risk exposure)".

(2) Section 71(1), English text—

Repeal

"the off-balance sheet"

Substitute

"the".

(3) Section 71(1), Table 10, heading—

Repeal

"OTC Derivative Transactions or Credit Derivative Contracts"

Substitute

"Default Risk Exposures".

(4) Section 71—

Repeal subsections (2) and (3)

Substitute

"(2) If—

(a) an authorized institution has posted unsegregated collateral to a counterparty for a transaction or contract booked in its banking book or trading book; and

(b) either—

(i) the collateral is not posted for a derivative contract or SFT; or

(ii) the collateral is posted for a derivative contract or SFT but is not included in the calculation of default risk exposures under Division 1A, 2 or 2B of Part 6A,

the institution must calculate the credit equivalent amount of its off-balance sheet exposure to the counterparty in respect of the collateral as the product of the principal amount (without deduction of any specific provisions) of the collateral and a factor of (1 + H).

(3) For the purposes of subsection (2), H is the standard supervisory haircut applicable to the collateral, subject to adjustment set out in section 92.

(4) An authorized institution may deduct from the credit equivalent amount calculated in accordance with subsection (2) any specific provisions applicable to the exposure concerned.

(5) An authorized institution must calculate its default risk exposure in respect of derivative contracts or SFTs by using the approach or methods set out in Division 1A, 2 or 2B of Part 6A, as the case requires.".

18. Sections 72 and 73 substituted

Sections 72 and 73—

Repeal the sections

Substitute

“72. Provision supplementary to section 71(1)

For the purposes of section 71(1), if—

(a) an off-balance sheet exposure of an authorized institution arises from a commitment in the form of a general banking facility that consists of 2 or more credit lines; and

(b) under each such credit line, the institution is obliged either to provide funds or create off-balance sheet exposures in the future,

the institution must assign a CCF to the exposure in accordance with item 9(a), (b) or (c) of Table 10 based on the original maturity of the commitment.

73. Calculation of credit equivalent amount of off-balance sheet exposures not covered by section 71(1), (2) or (5)

(1) This section applies to an off-balance sheet exposure that is not any of the following—

(a) an off-balance sheet exposure the credit equivalent amount of which is calculated in accordance with section 71(1);

(b) an off-balance sheet exposure the credit equivalent amount of which is calculated in accordance with section 71(2);

(c) a default risk exposure mentioned in section 71(5).

(2) An authorized institution must calculate the credit equivalent amount of an off-balance sheet exposure by multiplying the principal amount of the exposure, after deducting any specific provisions applicable to the exposure, by—

(a) if a CCF applicable to the exposure is specified in Part 2 of Schedule 1—that CCF; or

(b) if no such CCF is specified—a CCF of 100%.”.

19. Section 76A substituted

Section 76A—

Repeal the section

Substitute

“76A. Calculation of risk-weighted amount of default risk exposures in respect of SFTs

(1) If the default risk exposure of an authorized institution in respect of an SFT is calculated in accordance with section 226MJ, the institution must calculate the risk-weighted amount of the exposure in accordance with section 85, or sections 88 and 93 (with the net credit exposure reduced by any specific provisions made), as the case requires.

(2) If the default risk exposure of an authorized institution in respect of SFTs entered into with a counterparty is calculated in accordance with Division 2 of Part 6A, section 226MK or 226ML, the institution must calculate the risk-weighted amount of the exposure (net of specific provisions, if applicable) by allocating the attributed risk-weight of the counterparty to the exposure.

(3) For the purposes of subsections (1) and (2), an authorized institution may reduce the risk-weighted amount by taking into account any recognized guarantee or recognized credit derivative contract applicable to the default risk exposure in the way set out in Divisions 9 and 10.”.

20. Section 77 amended (recognized collateral)

(1) Section 77(ea)—

Repeal

"OTC derivative transactions, credit".

(2) Section 77(h)(ii)—

Repeal

"assumed".

21. Section 78 amended (approaches to use of recognized collateral)

Section 78—

Repeal subsection (1)

Substitute

"(1) Subject to subsection (2), an authorized institution may use the simple approach or the comprehensive approach in its treatment of recognized collateral for the purpose of calculating the risk-weighted amounts of its exposures that are not default risk exposures (***non-default risk exposures***).

(1A) Subject to subsection (2), an authorized institution may use the simple approach or the comprehensive approach to take into account the credit risk mitigation effect of recognized collateral for the purpose of calculating the risk-weighted amount of a default risk exposure only if either of the following is complied with in respect of the exposure—

(a) the exposure is in respect of an SFT calculated in accordance with section 226MJ;

(b) the exposure is in respect of one or more than one derivative contract entered into by the institution

with a counterparty and the conditions specified in subsection (1B) are met.

(1B) The conditions are—

(a) the institution entered into the contract or contracts with the counterparty under a general banking facility consisting of 2 or more credit lines, and, for at least one of those credit lines, if drawn (whether in full or not), the drawn portion that will result from such drawdown is, at the time of the drawdown, a non-default risk exposure;

(b) the credit lines are secured by the same recognized collateral;

(c) no amount of the recognized collateral is designated solely for offsetting losses on default risk exposures incurred by the institution under the general banking facility; and

(d) the recognized collateral is not included in the calculation of the default risk exposure under Division 1A or 2 of Part 6A.

(1C) If the same recognized collateral is available to cover both default risk exposures and non-default risk exposures, an authorized institution may, under the simple approach or comprehensive approach, take into account the credit risk mitigation effect of the recognized collateral for the purpose of calculating the risk-weighted amount of the non-default risk exposures only to the extent of the current market value, or the part of such value, of the collateral that is not included in the calculation of the default risk exposures under Division 1A or 2 of Part 6A.".

22. Section 79 amended (collateral which may be recognized for purposes of section 77(i)(i))

(1) Section 79(1)—

Repeal

"subsection (2)"

Substitute

"subsections (2) and (3)".

(2) After section 79(2)—

Add

"(3) If a debt security issued by a sovereign has neither a long-term ECAI issue specific rating nor short-term ECAI issue specific rating, an authorized institution may, for the purposes of this section, regard the ECAI issuer rating of the sovereign, if any, as the long-term ECAI issue specific rating of the debt security.".

23. Section 80 amended (collateral which may be recognized for purposes of section 77(i)(ii))

(1) Section 80(1)(a)—

Repeal

"recognized".

(2) Section 80(1)(d)—

Repeal

"securities"

Substitute

"securities that are eligible for being included in trading book and".

24. Section 82 amended (determination of risk-weight to be allocated to recognized collateral under simple approach)

(1) Section 82(4)—

Repeal paragraphs (a) and (b).

(2) Section 82(4)(d), after "transaction"—

Add

"(other than derivative contract and repo-style transaction)".

25. Section 84 amended (calculation of risk-weighted amount of off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts)

(1) Section 84, heading—

Repeal

"OTC derivative transactions or credit derivative contracts"

Substitute

"default risk exposures".

(2) Section 84—

Repeal

"neither an OTC derivative transaction nor a credit derivative contract"

Substitute

"not a default risk exposure".

26. Section 85 amended (calculation of risk-weighted amount of OTC derivative transactions and credit derivative contracts)

(1) Section 85, heading—

Repeal

"OTC derivative transactions and credit derivative contracts"

Substitute

"default risk exposures".

(2) Section 85(1)—

Repeal

everything before "by—"

Substitute

"(1) An authorized institution must calculate the risk-weighted amount of its default risk exposure that is an exposure mentioned in section 78(1A)(a) or (b)".

(3) Section 85(1)(a)—

Repeal

"outstanding default risk exposure of the transaction"

Substitute

"amount of the default risk exposure in respect of an SFT or the outstanding default risk exposure calculated for one or more than one derivative contract".

(4) Section 85—

Repeal subsection (2).

27. Section 87 amended (calculation of net credit exposure of on-balance sheet exposures)

Section 87, Formula 2—

Repeal

"for the comprehensive approach to the treatment of recognized collateral" (wherever appearing).

28. Section 88 amended (calculation of net credit exposure of off-balance sheet exposures other than credit derivative contracts or OTC derivative transactions)

(1) Section 88, heading—

Repeal

"credit derivative contracts or OTC derivative transactions"

Substitute

"default risk exposures in respect of derivative contracts".

(2) Section 88—

Repeal

"a credit derivative contract or an OTC derivative transaction"

Substitute

"a default risk exposure in respect of derivative contracts".

(3) Section 88, Formula 3, heading—

Repeal

"Credit Derivative Contract or OTC Derivative Transaction"

Substitute

"Default Risk Exposure in Respect of Derivative Contracts".

(4) Section 88, Formula 3—

Repeal

"principal amount of off-balance sheet exposure net of specific provisions, if any;"

Substitute

"either of the following—

(a) if the off-balance sheet exposure is a default risk exposure mentioned in section 78(1A)(a)—the default risk exposure;

(b) in any other case—principal amount of the off-balance sheet exposure, net of specific provisions (if any);".

(5) Section 88, Formula 3—

Repeal

"haircut applicable to the authorized institution's exposure to the obligor pursuant to the standard supervisory haircuts for the comprehensive approach to the treatment of recognized collateral subject to adjustment as set out in section 92;"

Substitute

"either of the following—

(a) unless paragraph (b) applies—haircut applicable to the authorized institution's exposure to the obligor pursuant to the standard supervisory haircuts subject to adjustment as set out in section 92;

(b) if the off-balance sheet exposure is a default risk exposure mentioned in section 78(1A)(a)—haircut applicable to the securities provided by the institution to the obligor under the SFT concerned pursuant to the standard supervisory haircuts subject to adjustment as set out in section 92;".

(6) Section 88, Formula 3—

Repeal

"recognized collateral pursuant to the standard supervisory haircuts for the comprehensive approach to the treatment of recognized collateral"

Substitute

"recognized collateral pursuant to the standard supervisory haircuts".

(7) Section 88, Formula 3—

Repeal

"currency mismatch, if any, pursuant to the standard supervisory haircuts for the comprehensive approach to the treatment of recognized collateral"

Substitute

"currency mismatch, if any, pursuant to the standard supervisory haircuts".

(8) Section 88, Formula 3—

Repeal

"CCF applicable to the off-balance sheet exposure."

Substitute

"either of the following—

(a) if the off-balance sheet exposure is a default risk exposure mentioned in section 78(1A)(a)—100%;

(b) in any other case—CCF applicable to the off-balance sheet exposure.".

29. Section 89 amended (calculation of net credit exposure of credit derivative contracts and OTC derivative transactions)

(1) Section 89, heading—

Repeal

"credit derivative contracts and OTC derivative transactions"

Substitute

"default risk exposures in respect of derivative contracts".

(2) Section 89—

Repeal

"shall calculate its net credit exposure to a counterparty in respect of a credit derivative contract, or an OTC derivative transaction,"

Substitute

"must calculate the net credit exposure of its default risk exposure that is an exposure mentioned in section 78(1A)(b)".

(3) Section 89, Formula 4, heading—

Repeal

"Credit Derivative Contract or OTC Derivative Transaction"

Substitute

"Derivative Contracts".

(4) Section 89, Formula 4—

Repeal

"of the credit derivative contract or OTC derivative transaction, as the case may be, net of specific provisions, if any"

Substitute

"calculated for the derivative contracts concerned, net of specific provisions (if any)".

(5) Section 89, Formula 4—

Repeal

"for the comprehensive approach to the treatment of recognized collateral" (wherever appearing).

30. Section 90 amended (haircuts)

Section 90, Formula 5—

Repeal

"for the comprehensive approach to the treatment of recognized collateral".

31. Section 91 amended (minimum holding periods)

(1) Before section 91(1)—

Add

"(1AA) For the purposes of section 87, 88, 89, 90, 94, 100 or 103 and subject to subsection (4), an authorized institution must, in order to determine the haircuts applicable to an exposure and the recognized collateral provided in respect of the exposure, set the minimum holding period of the transaction giving rise to the exposure as—

(a) if the exposure is not a default risk exposure or is a default risk exposure mentioned in section 78(1A)(a)—the minimum holding period determined in accordance with subsections (1), (2) and (3); or

(b) if the exposure is a default risk exposure mentioned in section 78(1A)(b)—the minimum holding period or the margin period of risk of the transaction determined in accordance with Part 6A.".

(2) Section 91(1)—

Repeal everything after paragraph (b)

Substitute

"the institution must determine the minimum holding period of the transaction giving rise to the exposure in accordance with Table 12 based on the type of transaction to which the transaction belongs.".

(3) Section 91(1), Table 12, heading—

Repeal

"**Assumed**".

(4) Section 91(1), Table 12, column 2—

Repeal

"Assumed minimum"

Substitute

"Minimum".

(5) Section 91(2)—

Repeal

"assumed".

(6) After section 91(2)—

Add

"(3) If—

(a) an exposure is not subject to daily remargining; or

(b) an exposure and the recognized collateral provided in respect of the exposure are not subject to daily revaluation,

the minimum holding period of the transaction giving rise to the exposure must be calculated by using Formula 5A.

Formula 5A

Calculation of Minimum Holding Period for Circumstances Set Out in Paragraphs (a) and (b)

$$\text{Minimum holding period} = N_R + (T_M - 1)$$

where—

N_R = actual number of days between each remargining or each revaluation; and

T_M = minimum holding period determined in accordance with subsections (1) and (2) for the transaction as if there were daily remargining or daily revaluation.

(4) When calculating the credit equivalent amount of an off-balance sheet exposure to a counterparty arising from unsegregated collateral posted to the counterparty for mitigating the credit risk of a contract or transaction in accordance with section 71(2), an authorized institution must, for the purpose of determining the haircut applicable to the collateral—

(a) determine the minimum holding period or the margin period of risk of the contract or transaction in accordance with subsections (1), (2) and (3) or Part 6A, as the case requires; and

(b) take the minimum holding period or the margin period of risk determined under paragraph (a) to be the minimum holding period of the collateral.".

32. Section 92 substituted

Section 92—

Repeal the section

Substitute

"92. Adjustment of standard supervisory haircuts in certain circumstances

Where an authorized institution is required under these Rules to use a haircut to take into account the volatility of the value of an exposure, collateral or exchange rate, if—

(a) the minimum holding period or the margin period of risk of the transaction giving rise to the exposure determined in accordance with section 91(1), (2) and (3) or Part 6A is not 10 business days; or

(b) the minimum holding period of the collateral determined in accordance with section 91(4) is not 10 business days,

the institution must determine the value of the haircut by adjusting the standard supervisory haircut concerned in accordance with section 3 of Schedule 7.".

33. Sections repealed

Sections 94A, 95, 96 and 97—

Repeal the sections.

34. Section 100 amended (capital treatment of recognized guarantees and recognized credit derivative contracts)

(1) Section 100(4), Formula 11—

Repeal

"for the comprehensive approach to the treatment of recognized collateral".

(2) Section 100(10)—

Repeal paragraphs (a) and (b)

Substitute

"(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP;

(ii) the institution is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(iii) the institution is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution;

(b) a risk-weight of 4% if the institution is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met; or

(c) a risk-weight of 4% if the institution is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution .".

35. Section 101 amended (provisions supplementary to section 100)

Section 101(6A)—

Repeal paragraphs (a) and (b)

Substitute

"(a) "a risk-weight of 2%" if—

(i) the authorized institution concerned is a clearing member of the qualifying CCP;

(ii) the authorized institution concerned is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(iii) the authorized institution concerned is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution;

(b) "a risk-weight of 4%" if the authorized institution concerned is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met; or

(c) "a risk-weight of 4%" if the authorized institution concerned is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution.".

36. Section 103 amended (maturity mismatches)

(1) Section 103(1)—

Repeal

", OTC derivative transactions and credit"

Substitute

"and".

(2) Section 103(1), Formula 12—

Repeal

"for price volatility"

Substitute

"(subject to adjustment as set out in section 92) for volatility of value".

37. Section 105 amended (interpretation of Part 5)

(1) Section 105, definition of ***credit equivalent amount***—

Repeal

", means the credit equivalent amount of the exposure calculated under section 118"

Substitute

"that is not a default risk exposure, means the credit equivalent amount of the exposure calculated in accordance with section 118(1) or (2)".

(2) Section 105, definition of ***principal amount***, paragraph (b)(i), after "Table 14"—

Add

"or to which section 120(2) applies".

(3) Section 105, definition of ***principal amount***, paragraph (b)(ii)—

Repeal

"arising"

Substitute

"or to which section 120(2) applies that arises".

(4) Section 105, definition of ***principal amount***, paragraph (b)—

Repeal subparagraphs (iii) and (iv)

Substitute

"(iii) subject to subparagraph (iv), in the case of an exposure in respect of a derivative contract, the notional amount of the contract;

(iv) in the case of an exposure in respect of a derivative contract where the stated notional amount of the contract is leveraged or enhanced by the structure of the contract, the effective notional amount of the contract calculated by taking into account the effect of the leverage or enhancement, as the case requires;".

(5) Section 105, definition of ***SFT risk-weighted amount***—

Repeal

everything after "calculated as the"

Substitute

"sum of the risk-weighted amounts of the default risk exposures across all the SFTs with the counterparty calculated in accordance with section 123A;".

(6) Section 105—

(a) definition of ***non-qualifying reference obligation***;

(b) definition of ***qualifying reference obligation***—

Repeal the definitions.

38. Section 106 amended (calculation of risk-weighted amount of exposures)

(1) Section 106(3)(a)—

Repeal

"OTC derivative transactions, credit".

(2) Section 106(3)(a)(iii), before ", the SFT"—

Add

"or SA-CCR risk-weighted amount, as the case requires".

(3) Section 106(3)(c)—

Repeal

"OTC derivative transactions, credit".

(4) Section 106(4)(b)—

Repeal

"CEM"

Substitute

"SA-CCR".

39. Section 107 amended (on-balance sheet exposures and off-balance sheet exposures to be covered)

(1) Section 107(1)(b)(i)—

Repeal

"OTC derivative transactions, credit".

(2) Section 107(1)(b)—

Repeal subparagraph (ii)

Substitute

"(ii) in respect of unsegregated collateral posted by the institution for transactions or contracts booked in its trading book; and".

40. Section 117B repealed (application of sections 118(2) and (3), 119 and 120(b) and (c))

Section 117B—

Repeal the section.

41. Section 118 amended (off-balance sheet exposures)

(1) Section 118(1), after "amount of an off-balance sheet exposure"—

Add

"(other than default risk exposure)".

(2) Section 118(1), English text—

Repeal

"amount of the off-balance sheet"

Substitute

"amount of the".

(3) Section 118(1), Table 14, heading—

Repeal

"OTC Derivative Transactions or Credit Derivative Contracts"

Substitute

"Default Risk Exposures".

(4) Section 118—

Repeal subsections (2) and (3)

Substitute

"(2) If—

(a) an authorized institution has posted unsegregated collateral to a counterparty for a transaction or contract booked in its banking book or trading book; and

(b) either—

(i) the collateral is not posted for a derivative contract or SFT; or

(ii) the collateral is posted for a derivative contract or SFT but is not included in the calculation of default risk exposure under Division 1A, 2, 2A or 2B of Part 6A,

the institution must treat the principal amount of the collateral, net of specific provisions, as the credit equivalent amount of its off-balance sheet exposure to the counterparty in respect of the collateral.

(3) An authorized institution must calculate its default risk exposure in respect of derivative contracts or SFTs by using the approach or methods set out in Division 1A, 2, 2A or 2B of Part 6A, as the case requires.".

42. Sections 119 and 120 substituted

Sections 119 and 120—

Repeal the sections

Substitute

"119. Provision supplementary to section 118(1)

For the purposes of section 118(1), if—

(a) an off-balance sheet exposure of an authorized institution arises from a commitment in the form of a general banking facility that consists of 2 or more credit lines; and

(b) under each such credit line, the institution is obliged either to provide funds or create off-balance sheet exposures in the future,

the institution must assign a CCF to the exposure in accordance with item 9(a), (b) or (c) of Table 14 based on the original maturity of the commitment.

120. Calculation of credit equivalent amount of off-balance sheet exposures not covered by section 118(1), (2) or (3)

(1) This section applies to an off-balance sheet exposure that is not any of the following—

(a) an off-balance sheet exposure the credit equivalent amount of which is calculated in accordance with section 118(1);

(b) an off-balance sheet exposure the credit equivalent amount of which is determined in accordance with section 118(2);

(c) a default risk exposure mentioned in section 118(3).

(2) An authorized institution must calculate the credit equivalent amount of an off-balance sheet exposure by multiplying the principal amount of the exposure, after deducting any specific provisions applicable to the exposure, by—

(a) if a CCF applicable to the exposure is specified in Part 2 of Schedule 1—that CCF; or

(b) if no such CCF is specified—a CCF of 100%.".

43. Section 123A substituted

Section 123A—

Repeal the section

Substitute

"123A. Calculation of risk-weighted amount of default risk exposures in respect of SFTs

(1) If the default risk exposure of an authorized institution in respect of an SFT is calculated in accordance with section 226MJ, the institution must calculate the risk-weighted amount of the exposure in accordance with section 129.

(2) If the default risk exposure of an authorized institution in respect of SFTs entered into with a counterparty is calculated by using the IMM(CCR) approach, the institution must calculate the risk-weighted amount of the exposure (net of specific provisions, if applicable) by allocating the attributed risk-weight of the counterparty to the exposure.

(3) For the purposes of subsections (1) and (2), an authorized institution may reduce the risk-weighted amount by taking into account any recognized guarantee or recognized credit derivative contract applicable to the default risk exposure in the way set out in Divisions 7 and 8.".

44. Section 124 amended (recognized collateral)

Section 124(ea)—

Repeal

"OTC derivative transactions, credit".

45. Section 126 amended (calculation of risk-weighted amount of exposures taking into account credit risk mitigation effect of recognized collateral)

(1) Section 126—

Repeal subsection (1)

Substitute

"(1) An authorized institution may take into account the credit risk mitigation effect of recognized collateral in the calculation of the risk-weighted amounts of its exposures that are not default risk exposures (***non-default risk exposures***) only in accordance with section 127 or 128, as the case requires.

(1A) An authorized institution may take into account the credit risk mitigation effect of recognized collateral in the calculation of the risk-weighted amount of a default risk

exposure in accordance with section 129 only if any of the following is complied with in respect of the exposure—

(a) the exposure is in respect of a derivative contract calculated by using the current exposure method;

(b) the exposure is in respect of an SFT calculated in accordance with section 226MJ; or

(c) the following—

(i) the exposure is in respect of one or more than one derivative contract entered into by the institution with a counterparty;

(ii) the exposure is calculated by using the SA-CCR approach or the IMM(CCR) approach; and

(iii) the conditions specified in subsection (1B) are met.

(1B) The conditions are—

(a) the institution entered into the contract or contracts with the counterparty under a general banking facility consisting of 2 or more credit lines, and, for at least one of those credit lines, if drawn (whether in full or not), the drawn portion that will result from such drawdown is, at the time of the drawdown, a non-default risk exposure;

(b) the credit lines are secured by the same recognized collateral;

(c) no amount of the recognized collateral is designated solely for offsetting losses on default risk exposures incurred by the institution under the general banking facility; and

(d) the recognized collateral is not included in the calculation of the default risk exposure under Division 1A or 2 of Part 6A.

(1C) If the same recognized collateral is available to cover both default risk exposures and non-default risk exposures, an authorized institution may, under section 127 or 128, take into account the credit risk mitigation effect of the recognized collateral for the purpose of calculating the risk-weighted amount of the non-default risk exposures only to the extent of the current market value, or the part of such value, of the collateral that is not included in the calculation of the default risk exposures under Division 1A or 2 of Part 6A.

(1D) However, the calculation in accordance with section 127, 128 or 129 is subject to subsections (2), (3) and (4).".

(2) Section 126—

Repeal subsection (3)

Substitute

"(3) An authorized institution must, if the exposure and the recognized collateral have currency mismatch, reduce the value of the collateral by a standard haircut of 8%.".

46. Section 128 amended (calculation of risk-weighted amount of off-balance sheet exposures other than OTC derivative transactions or credit derivative contracts)

(1) Section 128, heading—

Repeal

"OTC derivative transactions or credit derivative contracts"

Substitute

"default risk exposures".

(2) Section 128—

Repeal

"neither an OTC derivative transaction nor a credit derivative contract"

Substitute

"not a default risk exposure".

47. Section 129 amended (calculation of risk-weighted amount of OTC derivative transactions and credit derivative contracts)

(1) Section 129, heading—

Repeal

"OTC derivative transactions and credit derivative contracts"

Substitute

"default risk exposures".

(2) Section 129(1)—

Repeal

everything before "by—"

Substitute

"(1) An authorized institution must calculate the risk-weighted amount of its default risk exposure that is an exposure mentioned in section 126(1A)(a), (b) or (c)".

(3) Section 129(1)(a)—

Repeal

"outstanding default risk exposure of the transaction"

Substitute

"amount of the default risk exposure in respect of an SFT or the outstanding default risk exposure calculated for one or more than one derivative contract".

(4) Section 129—

Repeal subsection (2).

48. Sections 130A and 131 repealed

Sections 130A and 131—

Repeal the sections.

49. Section 134 amended (capital treatment of recognized guarantees and recognized credit derivative contracts)

Section 134(7)—

Repeal paragraphs (a) and (b)

Substitute

"(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP;

(ii) the institution is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(iii) the institution is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution;

(b) a risk-weight of 4% if the institution is a direct client of a clearing member of the qualifying CCP, and all the

conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met; or

(c) a risk-weight of 4% if the institution is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution.".

50. Section 135 amended (provisions supplementary to section 134)

Section 135(6A)—

Repeal paragraphs (a) and (b)

Substitute

"(a) "a risk-weight of 2%" if—

(i) the authorized institution concerned is a clearing member of the qualifying CCP;

(ii) the authorized institution concerned is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(iii) the authorized institution concerned is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution;

(b) "a risk-weight of 4%" if the authorized institution concerned is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met; or

(c) "a risk-weight of 4%" if the authorized institution concerned is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution.".

51. Section 137 amended (maturity mismatches)

Section 137(1)—

Repeal

"OTC derivative transactions and credit".

52. Section 139 amended (interpretation of Part 6)

(1) Section 139(1), definition of ***credit equivalent amount***—

Repeal

everything after "institution"

Substitute

"that is not a default risk exposure, means the value obtained by multiplying the principal amount of the exposure by the applicable CCF;".

(2) Section 139(1), definition of ***expected loss amount***, paragraph (b)—

Repeal

"OTC derivative transaction or credit".

(3) Section 139(1), definition of ***principal amount***—

Repeal paragraph (b)(i) and (ii).

(4) Section 139(1), definition of ***principal amount***, paragraph (b)(iii), after "Table 20"—

Add

"or to which section 166 or 182 applies".

(5) Section 139(1), definition of ***principal amount***, paragraph (b)(iv)—

Repeal

"arising"

Substitute

"or to which section 166 or 182 applies that arises".

(6) Section 139(1), definition of ***SFT risk-weighted amount***—

Repeal

everything after "calculated as the"

Substitute

"sum of the risk-weighted amounts of the default risk exposures across all the SFTs with the counterparty calculated in accordance with section 202;".

53. Section 140 amended (calculation of risk-weighted amount of exposures)

(1) Section 140(1C)—

Repeal

"OTC derivative transactions, credit".

(2) Section 140(1C)(a)(ii), (b)(ii) and (c)(i)—

Repeal

"CEM"

Substitute

"SA-CCR".

54. Section 140A amended (calculation of exposure at default)

Section 140A(1)—

Repeal

"164A, 165, 166, 179, 180, 180A"

Substitute

"165, 166, 179, 180".

55. Section 141 amended (exposures to be covered)

(1) Section 141(1)(b)(i)—

Repeal

"OTC derivative transactions, credit".

(2) Section 141(1)(b)—

Repeal subparagraph (ii)

Substitute

"(ii) in respect of unsegregated collateral posted by the institution for transactions or contracts booked in its trading book.".

56. Section 145 amended (equity exposures)

Section 145(1)(b)(ii)—

Repeal

"equity"

Substitute

"equity-related derivative".

57. Section 156 amended (calculation of risk-weighted amount of corporate, sovereign and bank exposures)

Section 156(9)(a) and (b)—

Repeal

"OTC derivative transactions or credit".

58. Section 160 amended (loss given default under foundation IRB approach)

Section 160(3), Formula 19—

Repeal

"for the comprehensive approach to treatment of recognized collateral" (wherever appearing).

59. Section 163 amended (exposure at default under foundation IRB approach—on-balance sheet exposures and off-balance sheet exposures other than OTC derivative transactions and credit derivative contracts)

(1) Section 163, heading—

Repeal

"OTC derivative transactions and credit derivative contracts"

Substitute

"default risk exposures".

(2) Section 163(2), after "EAD of an off-balance sheet exposure"—

Add

"(other than default risk exposure)".

(3) Section 163(2), Table 20, heading—

Repeal

"OTC Derivative Transactions or Credit Derivative Contracts"

Substitute

"Default Risk Exposures".

(4) Before section 163(3)—

Add

"(2A) Where an authorized institution that uses the foundation IRB approach has an off-balance sheet exposure to a counterparty arising from unsegregated collateral posted to the counterparty, if—

(a) the collateral is posted for a transaction or contract booked in the institution's banking book or trading book; and

(b) either—

(i) the transaction or contract is not a derivative contract or SFT; or

(ii) the transaction or contract is a derivative contract or SFT but the collateral is not included in the calculation of default risk exposures under Division 1A, 2 or 2B of Part 6A,

the institution must estimate the EAD of the off-balance sheet exposure as the product of the principal amount of the collateral and a factor of (1 + H).

(2B) For the purposes of subsection (2A), H is the standard supervisory haircut applicable to the collateral, subject to adjustment set out in section 3 of Schedule 7 with the minimum holding period applicable to the collateral determined in the same way as set out in section 91(4).".

60. Section 164 amended (exposure at default under advanced IRB approach—on-balance sheet exposures and off-balance sheet exposures other than OTC derivative transactions and credit derivative contracts)

(1) Section 164, heading—

Repeal

"OTC derivative transactions and credit derivative contracts"

Substitute

"default risk exposures".

(2) Section 164—

Repeal subsection (2)

Substitute

"(2) An authorized institution that uses the advanced IRB approach must—

(a) estimate the EAD of an off-balance sheet exposure of the institution specified in column 2 of Table 20 in accordance with subsections (3) and (4); and

(b) estimate the EAD of an off-balance sheet exposure of the institution to a counterparty arising from unsegregated collateral posted to the counterparty in accordance with subsections (4) and (4A) if—

(i) the collateral is posted for a transaction or contract booked in the institution's banking book or trading book; and

(ii) either—

(A) the transaction or contract is not a derivative contract or SFT; or

(B) the transaction or contract is a derivative contract or SFT but the collateral is not included in the calculation of default risk exposures under Division 1A, 2 or 2B of Part 6A.".

(3) After section 164(4)—

Add

"(4A) The EAD for an authorized institution's off-balance sheet exposure estimated under subsection (2)(b) must not be lower than the principal amount of the collateral concerned.".

61. Section 164A repealed (application of sections 165 and 166(b) and (c))

Section 164A—

Repeal the section.

62. Sections 165 and 166 substituted

Sections 165 and 166—

Repeal the sections

Substitute

"165. Exposure at default under foundation IRB approach or advanced IRB approach—default risk exposures in respect of derivative contracts

An authorized institution that uses the foundation IRB approach or the advanced IRB approach must determine the outstanding default risk exposure in respect of derivative contracts booked in the banking book or trading book of the institution based on the default risk exposure calculated for the

contracts by using the SA-CCR approach or the IMM(CCR) approach, as the case requires.

166. Exposure at default under foundation IRB approach or advanced IRB approach—off-balance sheet exposures not covered by sections 163, 164, 165 and 202

(1) This section applies to an off-balance sheet exposure that is not any of the following—

(a) an off-balance sheet exposure specified in column 2 of Table 20;

(b) an off-balance sheet exposure the EAD of which is estimated in accordance with section 163(2A) or 164(2)(b);

(c) a default risk exposure mentioned in section 165 or 202.

(2) An authorized institution that uses the foundation IRB approach or the advanced IRB approach must, in estimating the EAD of its off-balance sheet exposure, calculate the credit equivalent amount of the exposure—

(a) by applying—

(i) if a CCF applicable to the exposure is specified in Part 2 of Schedule 1—that CCF; or

(ii) if no such CCF is specified—a CCF of 100%; and

(b) in accordance with section 163 or 164, as the case requires, with all necessary modifications.".

63. Section 168 amended (maturity under advanced IRB approach)

(1) Section 168(1)—

Repeal

"such that"

Substitute

"as follows".

(2) Section 168(1)—

Repeal paragraph (d)

Substitute

"(d) subject to paragraphs (ba) and (bb), if the exposure is a default risk exposure resulting from the netting of nettable derivative contracts, the M of the exposure is the greater of the following—

(i) the weighted average maturity of the contracts (using the notional amount of each contract for weighting the maturity of the contracts);

(ii) 1 year.".

(3) Section 168(4)(c)(i)—

Repeal

"OTC derivative transactions, credit".

(4) Section 168(5), definition of ***relevant short-term exposure***, paragraph (a)—

Repeal

"an OTC derivative transaction, credit"

Substitute

"a".

(5) Section 168(5), definition of ***relevant short-term exposure***, paragraph (a)—

Repeal

"transaction or contract"

Substitute

"contract or transaction".

(6) Section 168(5), definition of ***relevant short-term exposure***, paragraph (ab)—

Repeal

"transactions or contracts"

Substitute

"contracts or transactions".

64. Section 180 amended (exposure at default—off-balance sheet exposures other than OTC derivative transactions and credit derivative contracts)

Section 180, heading—

Repeal

"OTC derivative transactions and credit derivative contracts"

Substitute

"default risk exposures".

65. Section 180A repealed (application of sections 181 and 182(b) and (c))

Section 180A—

Repeal the section.

66. Section 181 amended (exposure at default—OTC derivative transactions and credit derivative contracts)

(1) Section 181, heading—

Repeal

"OTC derivative transactions and credit derivative contracts"

Substitute

"default risk exposures in respect of derivative contracts".

(2) Section 181—

Repeal

everything after "retail exposures"

Substitute

"that are default risk exposures in respect of derivative contracts as it applies to the institution's estimation of the EAD of its corporate, sovereign and bank exposures that are default risk exposures in respect of derivative contracts.".

67. Section 182 substituted

Section 182—

Repeal the section

Substitute

"182. Exposure at default—off-balance sheet exposures not covered by sections 180, 181 and 202

(1) This section applies to an off-balance sheet exposure that is not any of the following—

(a) an off-balance sheet exposure specified in column 2 of Table 20;

(b) a default risk exposure mentioned in section 181 or 202.

(2) An authorized institution that uses the retail IRB approach must, in estimating the EAD of its off-balance sheet exposure, calculate the credit equivalent amount of the exposure—

(a) by applying—

(i) if a CCF applicable to the exposure is specified in Part 2 of Schedule 1—that CCF; or

(ii) if no such CCF is specified—a CCF of 100%; and

(b) in accordance with section 180, with all necessary modifications.".

68. Section 194 amended (PD/LGD approach—calculation of risk-weighted amount of equity exposures)

Section 194(1)—

Repeal

"164A,".

69. Section 202 amended (securities financing transactions)

(1) Section 202(1)—

Repeal

"section 76A(4), (5), (6) and (7)"

Substitute

"Division 2B of Part 6A".

(2) Section 202(1)—

Repeal

"sections 75 and 76"

Substitute

"section 75".

(3) Section 202(2)—

Repeal

"sections 75, 76 and 76A(2)"

Substitute

"section 75 and Division 2 of Part 6A".

(4) Section 202(3)(b)—

Repeal

"referred to in section 10A(1)(b)"

Substitute

"set out in Division 2B of Part 6A".

(5) Section 202(3)—

Repeal

"section 76A(4), (5), (6) and (7)"

Substitute

"Division 2B of Part 6A".

(6) Section 202(3)—

Repeal

"sections 75 and 76"

Substitute

"section 75".

(7) Section 202(6)—

Repeal

"section 76A(2) or 76A(4), (5), (6) and (7)"

Substitute

"Division 2 or 2B of Part 6A".

70. Section 204 amended (recognized collateral)

(1) Section 204—

Renumber the section as section 204(1).

(2) Section 204(1), after "of the institution"—

Add

"that is not a default risk exposure (***non-default risk exposure***)".

(3) After section 204(1)—

Add

"(2) For the purposes of section 203(1)(a), an authorized institution may take into account the credit risk mitigating effect of recognized collateral in accordance with this Division in the calculation of the risk-weighted amount of a default risk exposure only if either of the following is complied with in respect of the exposure—

(a) the exposure is in respect of an SFT that is not nettable calculated in accordance with section 226MJ;

(b) the exposure is in respect of one or more than one derivative contract entered into by the institution with a counterparty and the conditions specified in subsection (3) are met.

(3) The conditions are—

(a) the institution entered into the contract or contracts with the counterparty under a general banking facility consisting of 2 or more credit lines, and, for at least one of those credit lines, if drawn (whether in full or not), the drawn portion that will result from such drawdown is, at the time of the drawdown, a non-default risk exposure;

(b) the credit lines are secured by the same recognized collateral;

(c) no amount of the recognized collateral is designated solely for offsetting losses on default risk exposures incurred by the institution under the general banking facility; and

(d) the recognized collateral is not included in the calculation of the default risk exposure under Division 1A or 2 of Part 6A.

(4) If the same recognized collateral is available to cover both default risk exposures and non-default risk exposures, an authorized institution may take into account the credit risk mitigating effect of the recognized collateral for the purpose of calculating the risk-weighted amount of the non-default risk exposures—

(a) only to the extent of the current market value, or the part of such value, of the collateral that is not included in the calculation of the default risk exposures under Division 1A or 2 of Part 6A; and

(b) in accordance with other applicable provisions in this Division relating to recognized collateral.".

71. Section 209 amended (recognized netting)

(1) Section 209(1)—

Repeal

"subsections (3A) and (3B)"

Substitute

"subsection (3B)".

(2) Section 209—

Repeal subsections (2) and (3)

Substitute

"(2) An authorized institution must—

(a) in calculating the EAD of its exposure to the counterparty in respect of the institution's on-balance sheet corporate, sovereign, bank, retail or other exposures—subject to subsection (4), apply

sections 94 and 103, with all necessary modifications, to take into account the credit risk mitigating effect of recognized netting; and

(b) in calculating the EAD of its exposure to the counterparty in respect of derivative contracts—take into account the credit risk mitigating effect of recognized netting in accordance with Division 1A or 2 of Part 6A, as the case requires.

(3) Subject to subsection (3B), an authorized institution may only take into account the credit risk mitigating effect of recognized netting in respect of repo-style transactions by—

(a) in relation to a corporate, sovereign or bank exposure of an authorized institution that uses the foundation IRB approach—taking the default risk exposure (that is, E*) calculated in accordance with section 226MK or 226ML, as the case requires, as the EAD for inclusion into the risk-weight function specified in Formula 16 or 17, as the case requires; or

(b) in relation to a corporate, sovereign or bank exposure of an authorized institution that uses the advanced IRB approach or a retail exposure of an authorized institution that uses the retail IRB approach—

(i) taking the default risk exposure (that is, E*) calculated in accordance with section 226MK or 226ML, as the case requires, as the EAD for inclusion into the risk-weight function specified in Formula 16, 17, 21, 22 or 23, as the case requires; and

(ii) applying its estimate of LGD to the default risk exposure (that is, E*) to the counterparty.".

(3) Section 209—

Repeal subsection (3A).

(4) Section 209(3B), before "Part 6A"—

Add

"Division 2 of".

(5) Section 209(3B)—

Repeal

"referred to in section 10A(1)(b)"

Substitute

"set out in Division 2B of Part 6A".

(6) Section 209(4)—

Repeal paragraph (a).

(7) Section 209(4)(b)—

Repeal

"sections 94 and 95"

Substitute

"section 94".

72. Section 216 amended (provisions supplementary to section 214(1)—substitution framework for corporate, sovereign and bank exposures under foundation IRB approach and for equity exposures under PD/LGD approach)

Section 216(3B)—

Repeal paragraphs (a) and (b)

Substitute

"(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP;

(ii) the institution is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(iii) the institution is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution;

(b) a risk-weight of 4% if the institution is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met; or

(c) a risk-weight of 4% if the institution is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution.".

73. Section 217 amended (provisions supplementary to section 214(1)—substitution framework for corporate, sovereign and bank exposures under advanced IRB approach and for retail exposures under retail IRB approach)

Section 217(5)—

Repeal paragraphs (a) and (b)

Substitute

"(a) a risk-weight of 2% if—

(i) the institution is a clearing member of the qualifying CCP;

(ii) the institution is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) are met; or

(iii) the institution is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution;

(b) a risk-weight of 4% if the institution is a direct client of a clearing member of the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)) are met; or

(c) a risk-weight of 4% if the institution is an indirect client within a multi-level client structure associated with the qualifying CCP, and all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution.".

74. Section 226A amended (interpretation of Part 6A)

(1) Section 226A, definition of ***spot transaction***—

Repeal

"(including gold)".

(2) Section 226A, English text, definition of ***spread gamma***—

Repeal

"spread."

Substitute

"spread;".

(3) Section 226A—

Add in alphabetical order

"***initial margin*** (開倉保證金) has the meaning given by section 226V(1);

underlying exposure (基礎風險承擔), in relation to a derivative contract, means the underlying asset, index, financial instrument, rate or thing as designated in the derivative contract;

variation margin (變動保證金), in relation to a margin agreement between 2 counterparties, means the collateral posted by one counterparty to the other counterparty, or exchanged between the 2 counterparties, on a regular basis based on the price movement or change in value of one or more transactions subject to the agreement.".

75. Part 6A, Division 1A added

Part 6A, after Division 1—

Add

"Division 1A—SA-CCR Approach

Subdivision 1—Interpretation and Application

226BA. Interpretation of Division 1A

In this Division—

asset class (資產類別) means a class of derivative contracts referred to in section 226BL(1);

basis transaction (基準差交易) means a derivative contract under which both legs of the contract are denominated in the same currency and the cash flows of the 2 legs depend on different risk factors from the same asset class;

hedging set (對沖組合) means a hedging set of derivative contracts classified under section 226BM, 226BN, 226BO, 226BP or 226BQ;

independent collateral (獨立抵押品), in relation to derivative contracts in a netting set entered into between 2 counterparties—

(a) means the collateral posted by one counterparty (***first counterparty***) to the other counterparty—

(i) that may be seized on the default of the first counterparty to offset losses on the netting set; and

(ii) the amount of which the first counterparty is required to post (which could be expressed as a fixed percentage of the notional amounts of the contracts) does not change in response to the changes in the market value of the contracts it secures; and

(b) includes initial margin and independent amount;

margined contract (保證金合約) means a derivative contract of an authorized institution covered by a variation margin agreement, but excludes a derivative contract that is structured so that any outstanding exposure under the contract is settled daily;

unmargined contract (無保證金合約) means a derivative contract of an authorized institution that—

(a) is not covered by a variation margin agreement; or

(b) is structured so that any outstanding exposure under the contract is settled daily;

variation margin agreement (變動保證金協議) means a margin agreement entered into by an authorized institution with a counterparty under which the counterparty has an obligation to post variation margin to the institution;

volatility transaction (波動性交易) means a derivative contract the payment under which is determined by reference to a measure of the volatility (historical or implied) of a risk factor and the measure is explicitly specified in the contract.

226BB. Application of Division 1A

This Division applies to an authorized institution that uses the SA-CCR approach to calculate default risk exposures in respect of derivative contracts.

Subdivision 2—Main Formula: Default Risk Exposure as Function of Replacement Cost and Potential Future Exposure

226BC. Calculation of default risk exposure under SA-CCR approach of single netting set containing unmargined contracts only

(1) This section applies to a netting set that contains unmargined contracts only.

(2) Subject to sections 226BH and 226BI, an authorized institution must use Formula 23AA to calculate the default risk exposure in respect of the netting set.

Formula 23AA

$$\text{Default risk exposure} = \alpha \times (RC + PFE)$$

where—

(a) $\alpha = 1.4$;

(b) RC is the replacement cost of the netting set calculated in accordance with subsection (3); and

(c) PFE is the potential future exposure of the netting set calculated in accordance with section 226BR(1).

(3) Subject to subsection (4), the replacement cost of the netting set is calculated by using Formula 23AB.

Formula 23AB

$$RC = \max(V - C\, ;\, 0)$$

where—

(a) RC is the replacement cost of the netting set;

(b) V is the current mark-to-market value of the netting set; and

(c) C is the haircut value of net collateral held for the netting set, which is equal to the net amount of independent collateral for the netting set calculated in accordance with section 226BJ(3).

(4) If the netting set is subject to a margin agreement entered into by an authorized institution with a counterparty under which only the institution has an obligation to post

variation margin, C in Formula 23AB is calculated by subtracting the value specified in paragraph (b) from the amount specified in paragraph (a)—

(a) the net amount of independent collateral for the netting set calculated in accordance with section 226BJ(3);

(b) the haircut value of variation margin posted by the institution under the margin agreement calculated in accordance with section 226BJ(4).

226BD. Calculation of default risk exposure under SA-CCR approach of single netting set covered by single variation margin agreement

(1) This section applies to a netting set—

(a) that is covered by a single variation margin agreement; and

(b) that contains margined contracts only.

(2) Subject to sections 226BH and 226BI, an authorized institution must use Formula 23AC to calculate the default risk exposure in respect of the netting set.

Formula 23AC

$$\text{Default risk exposure} = \alpha \times (RC + PFE)$$

where—

(a) $\alpha = 1.4$;

(b) RC is the replacement cost of the netting set calculated in accordance with subsection (3); and

(c) PFE is the potential future exposure of the netting set calculated in accordance with section 226BR(1).

(3) The replacement cost of the netting set is calculated by using Formula 23AD.

Formula 23AD

$$RC = \max(V - C\ ;\ TH + MTA - NICA\ ;\ 0)$$

where—

(a) RC is the replacement cost of the netting set;

(b) V is the current mark-to-market value of the netting set;

(c) NICA is the net amount of independent collateral for the netting set calculated in accordance with section 226BJ(3);

(d) C is the haircut value of net collateral held for the netting set, which is calculated as the sum of the net amount of non-independent collateral calculated in accordance with section 226BJ(1) and the NICA;

(e) TH is the margin threshold specified in the variation margin agreement concerned; and

(f) MTA is the minimum transfer amount specified in the variation margin agreement concerned.

226BE. Calculation of default risk exposure under SA-CCR approach of multiple netting sets covered by single variation margin agreement

(1) This section applies to netting sets—

(a) that are covered by a single variation margin agreement; and

(b) that contain margined contracts only.

(2) Subject to sections 226BH and 226BI, an authorized institution must use Formula 23AE to calculate the default risk exposure in respect of the netting sets.

Formula 23AE

$$\text{Default risk exposure} = \alpha \times (RC + PFE)$$

where—

(a) $\alpha = 1.4$;

(b) RC is the replacement cost of the netting sets calculated in accordance with subsection (3); and

(c) PFE is the potential future exposure of the netting sets calculated in accordance with section 226BS.

(3) The replacement cost of the netting sets is calculated by using Formula 23AF.

Formula 23AF

$$RC_{MA} = \max\left\{\sum_{NS \in MA} \max\{V_{NS}\ ;0\} - \max\{C_{MA}\ ;0\}\ ;0\right\} + X$$

$$X = \max\left\{\sum_{NS \in MA} \min\{V_{NS}\ ;0\} - \min\{C_{MA}\ ;0\}\ ;0\right\}$$

where—

(a) RC_{MA} is the replacement cost of all netting sets subject to variation margin agreement MA;

(b) V_{NS} is the current mark-to-market value of netting set NS;

(c) C_{MA} is the haircut value of net collateral held under variation margin agreement MA, which is calculated as the sum of the net amount of non-independent collateral calculated in accordance with section 226BJ(1) and the net amount of independent collateral calculated in accordance with section 226BJ(3); and

(d) $NS \in MA$ means netting set NS is covered by variation margin agreement MA.

226BF. Calculation of default risk exposure under SA-CCR approach of single netting set covered by multiple variation margin agreements

(1) This section applies to a netting set—

(a) that is covered by more than one variation margin agreement; and

(b) that contains margined contracts only.

(2) Subject to sections 226BH and 226BI, an authorized institution must use Formula 23AG to calculate the default risk exposure in respect of the netting set.

Formula 23AG

Default risk exposure = α × (RC + PFE)

where—

(a) α = 1.4;

(b) RC is the replacement cost of the netting set calculated in accordance with subsection (3); and

(c) PFE is the potential future exposure of the netting set calculated in accordance with section 226BR(2).

(3) The replacement cost of the netting set is calculated by using Formula 23AH.

Formula 23AH

RC = max (V – C ; TH + MTA – NICA ; 0)

where—

(a) RC is the replacement cost of the netting set;

(b) V is the current mark-to-market value of the netting set;

(c) NICA is the net amount of independent collateral for the netting set calculated in accordance with section 226BJ(3);

(d) C is the haircut value of net collateral held for the netting set, which is calculated as the sum of the net amount of non-independent collateral calculated

in accordance with section 226BJ(2) and the NICA;

(e) TH is the sum of the margin thresholds across all the variation margin agreements covering the margined contracts in the netting set; and

(f) MTA is the sum of the minimum transfer amounts across all the variation margin agreements covering the margined contracts in the netting set.

226BG. Calculation of default risk exposure under SA-CCR approach of single netting set containing both margined contracts and unmargined contracts

(1) This section applies to a netting set that contains both margined contracts (which may be covered by one or more than one variation margin agreement) and unmargined contracts.

(2) Subject to sections 226BH and 226BI, an authorized institution must use Formula 23AI to calculate the default risk exposure in respect of the netting set.

Formula 23AI

Default risk exposure = α × (RC + PFE)

where—

(a) α = 1.4;

(b) RC is the replacement cost of the netting set calculated in accordance with subsection (3); and

(c) PFE is the potential future exposure of the netting set calculated in accordance with section 226BR(2).

(3) Subject to subsection (4), the replacement cost of the netting set is calculated by using Formula 23AJ.

Formula 23AJ

$$RC = \max(V - C\ ;\ TH + MTA - NICA\ ;\ 0)$$

where—

(a) RC is the replacement cost of the netting set;

(b) V is the current mark-to-market value of all the margined contracts and unmargined contracts in the netting set;

(c) NICA is the net amount of independent collateral for the netting set calculated in accordance with section 226BJ(3);

(d) C is the haircut value of net collateral held for all the margined contracts and unmargined contracts in the netting set, which is calculated as the sum of the net amount of non-independent collateral calculated in accordance with section 226BJ(1) or (2) and the NICA;

(e) TH is—

(i) if the margined contracts in the netting set are covered by a single variation margin agreement—the margin threshold specified in that agreement; or

(ii) if the margined contracts in the netting set are covered by more than one variation margin agreement—the sum of the margin thresholds across all the variation margin agreements covering the margined contracts; and

(f) MTA is—

(i) if the margined contracts in netting set are covered by a single variation margin agreement—the minimum transfer amount specified in that agreement; or

(ii) if the margined contracts in the netting set are covered by more than one variation margin agreement—the sum of the minimum transfer amounts across all the variation margin agreements covering the margined contracts.

(4) If some of the contracts in the netting set are subject to a margin agreement entered into by an authorized institution with a counterparty under which only the institution has an obligation to post variation margin, C in Formula 23AJ is calculated by subtracting the value specified in paragraph (b) from the sum specified in paragraph (a)—

(a) the sum of the net amount of non-independent collateral calculated in accordance with section 226BJ(1) or (2) and the NICA calculated in accordance with section 226BJ(3);

(b) the haircut value of variation margin posted by the institution under the margin agreement calculated in accordance with section 226BJ(4).

226BH. Determination of default risk exposure in certain circumstances

(1) Subject to subsections (2), (3), (4) and (5), the amount of default risk exposure of a netting set that contains margined contracts (whether exclusively or not) calculated under section 226BD, 226BF or 226BG is capped at the amount that would have been calculated under section 226BC if the margined contracts in the netting set were unmargined contracts.

(2) If—

(a) a sold option of an authorized institution is not subject to any recognized netting;

(b) the premium for the option has been fully paid upfront by the counterparty concerned; and

(c) the option is not subject to any margin agreement,

the amount of default risk exposure to the counterparty in respect of the option may be set to zero.

(3) If a sold option of an authorized institution meets the criteria in subsection (2)(b) and (c) but is a transaction within a netting set that falls within paragraph (a)(i) of the definition of ***netting set*** in section 2(1), the amount of default risk exposure to the counterparty concerned in respect of the option may be set to zero only if—

(a) the netting set contains sold options only; or

(b) the sold option is removed from the netting set such that the default risk exposure in respect of the netting set is calculated without taking into account the sold option.

(4) If—

(a) an authorized institution is the protection seller in respect of a credit-related derivative contract with periodic premium payments and the contract is not subject to any recognized netting;

(b) the contract is not a sold option; and

(c) the contract is not subject to any margin agreement,

the amount of default risk exposure to the protection buyer in respect of the contract calculated under section 226BC is capped at the amount of the unpaid premium under the contract.

(5) If an authorized institution is the protection seller in respect of a credit-related derivative contract with periodic premium payments and the contract is a transaction within a netting set that falls within paragraph (a)(i) of the definition of ***netting set*** in section 2(1), the institution may apply the cap referred to in subsection (4) to the default risk exposure to the protection buyer in respect of the contract only if the institution—

(a) removes the contract from the netting net; and

(b) calculates the amount of the default risk exposure in accordance with section 226BC as if the contract were not subject to recognized netting and not subject to any margin agreement.

226BI. Treatments for certain credit derivative contracts

An authorized institution may treat the default risk exposure in respect of a credit derivative contract as zero if—

(a) both of the following conditions are met—

(i) the contract is a credit default swap in which the institution is the protection seller;

(ii) a regulatory capital is held in respect of the risk-weighted amount calculated in accordance with Part 4, 5, 6 or 7, as the case requires, for the institution's exposure to the credit risk of the reference obligation underlying the swap; or

(b) both of the following conditions are met—

(i) the institution is the protection buyer in the contract;

(ii) the credit risk mitigation effect of the contract has been recognized and taken into account under Divisions 9 and 10 of Part 4, Divisions 7 and 8 of Part 5, Division 10 of Part 6, or Division 5 of Part 7, for the purpose of calculating the risk-weighted amount of the exposure to which credit protection is provided by the contract.

226BJ. Calculation of haircut value of net collateral held

(1) In calculating the haircut value of net collateral held by an authorized institution for section 226BD(3), 226BE(3) or 226BG(3), the net amount of non-independent collateral referred to in that section must be calculated by using Formula 23AK.

Formula 23AK

$$C_{non\text{-}IC} = C_{received} \cdot [1 - H] - C_{posted} \cdot [1 + H]$$

where—

(a) $C_{non\text{-}IC}$ is the net amount of non-independent collateral held (if the resulting amount is positive) or posted (if the resulting amount is negative) under the variation margin agreement concerned;

(b) $C_{received}$ is the current market value of collateral (including variation margin but excluding independent collateral) received by the institution under the variation margin agreement concerned;

(c) C_{posted} is the current market value of collateral (including variation margin but excluding independent collateral) posted by the institution under the variation margin agreement concerned; and

(d) H is the standard supervisory haircut applicable to the collateral concerned, subject to adjustment set out in section 3 of Schedule 7 based on the margin period of risk appropriate for the derivative contracts concerned determined in accordance with section 226BZE(2), (3), (4), (5) and (6).

(2) In calculating the haircut value of net collateral held by an authorized institution for section 226BF(3) or 226BG(3), the net amount of non-independent collateral referred to in that section must be calculated as the sum of the net amount of non-independent collateral held or posted under each of the variation margin agreements concerned calculated by using Formula 23AK.

(3) In calculating the haircut value of net collateral held by an authorized institution for section 226BC(3), 226BD(3), 226BE(3), 226BF(3) or 226BG(3), the net amount of independent collateral must be calculated by using Formula 23AL.

Formula 23AL

$$NICA = ICA_{received} \cdot [1 - H] - ICA_{posted} \cdot [1 + H]$$

where—

(a) NICA is the net amount of independent collateral held (if the resulting amount is positive) or posted (if the resulting amount is negative);

(b) $ICA_{received}$ is the current market value of independent collateral posted by the counterparty concerned to the institution (regardless of whether the collateral is segregated in a bankruptcy remote account or not);

(c) ICA_{posted} is the current market value of independent collateral posted by the institution to the same counterparty, where the collateral is unsegregated collateral; and

(d) H is the standard supervisory haircut applicable to the collateral concerned, subject to adjustment set out in section 3 of Schedule 7 based on—

(i) if the collateral is received or posted for unmargined contracts—the

lower of—

(A) the minimum holding period calculated by using Formula 5A in section 91 with N_R in that formula being construed to mean the period from the current date to the maturity date of the contract in the netting set concerned that has the longest residual maturity; or

(B) a minimum holding period of 250 days; or

(ii) if the collateral is received or posted for margined contracts—the margin period of risk appropriate for the derivative contracts concerned determined in accordance with section 226BZE(2), (3), (4), (5) and (6).

(4) The haircut value of variation margin posted by an authorized institution referred to in sections 226BC(4) and 226BG(4) is calculated as the product of—

(a) the current market value of the variation margin posted by the authorized institution concerned; and

(b) a factor of (1 + H), where H has the same meaning as given by subsection (3) for collateral received or posted for unmargined contracts.

(5) Collateral posted to an authorized institution by a counterparty may be included in the calculation under subsection (1), (2) or (3) only if—

(a) the collateral—

(i) falls within the description in section 80(1)(a), (b) or (c); and

(ii) satisfies the requirements under section 77(a), (b), (c), (d), (e), (ea) and (f); and

(b) the collateral is not a re-securitization exposure.

(6) An authorized institution must include all collateral posted by it (except independent collateral that is not unsegregated collateral) to a counterparty in the calculation under subsection (1), (2), (3) or (4), regardless of whether the collateral meets the conditions set out in subsection (5)(a) and (b).

(7) If collateral that meets the descriptions in subsection (5) is received by an authorized institution outside a netting set but is available to offset losses on default risk exposures, the institution must, for the purposes of this section, treat the collateral in the following way—

(a) subject to paragraph (b)—

(i) if the collateral is available to offset losses on 1 netting set only, the collateral must be treated as an independent collateral received for that netting set; or

(ii) if the collateral is available to offset losses on more than one netting set, the collateral must be treated as if it were an independent collateral received under a single variation margin agreement that applies to multiple netting sets;

(b) if the collateral is available to offset not only losses on default risk exposures but also losses on exposures that are not default risk exposures, only that portion of the collateral designated solely for offsetting losses on default risk exposures can be treated as an independent collateral under paragraph (a)(i) or (ii).

226BK. Authorized institution to hold regulatory capital for credit risk or market risk of posted collateral

To avoid doubt, an authorized institution must, for collateral posted by it for a derivative contract (whether the collateral is included in the calculations under section 226BJ or not), hold regulatory capital for the credit risk or market risk, whichever is applicable, of the collateral itself calculated under Part 4, 5, 6, 7 or 8, as the case requires—

(a) as if it had not been posted as collateral; and

(b) if the collateral is held by another person, as if the collateral were held by the institution.

Subdivision 3—Classification of Derivative Contracts into Asset Classes and Further Classification into Hedging Sets

226BL. Classification of derivative contracts into asset classes

(1) Subject to subsections (2), (3) and (4), an authorized institution must classify each of the derivative contracts in a netting set into one of the following 5 asset classes—

(a) interest rate contracts;

(b) exchange rate contracts;

(c) credit-related derivative contracts;

(d) equity-related derivative contracts;

(e) commodity-related derivative contracts.

(2) In classifying a derivative contract, an authorized institution must—

(a) first determine the primary risk factor of the contract taking into account the sensitivities and volatility of the underlying exposure of the contract; and

(b) then—

(i) if the primary risk factor of the contract so determined is inflation—classify the contract into the asset class of interest rate contracts; or

(ii) in any other case—classify the contract into an asset class based on the contract's primary risk factor.

(3) The Monetary Authority may, by written notice given to an authorized institution, require the institution to classify a derivative contract of the institution into more than one asset class if the Monetary Authority considers that classifying the contract into only 1 asset class would significantly underestimate the default risk exposure in respect of the contract.

(4) An authorized institution given a notice under subsection (3) must, unless otherwise specified by the Monetary Authority in the notice—

(a) include the full position of the contract in each of the asset classes into which the contract is classified and determine the sign of each relevant risk factor in an appropriate way; and

(b) determine, for each asset class, the supervisory delta adjustment applicable to the contract in respect of the position included in the asset class in accordance with section 226BZB.

(5) An authorized institution must comply with the requirements of a notice given to it under subsection (3).

226BM. Further classification of derivative contracts in asset class of interest rate contracts

(1) All derivative contracts in a netting set that fall within the asset class of interest rate contracts must be further classified into different hedging sets as follows—

(a) non-inflation derivative contracts that are basis transactions referencing the same pair of risk factors must be grouped together to form a hedging set;

(b) inflation derivative contracts that are basis transactions referencing the same pair of risk factors must be grouped together to form a hedging set;

(c) non-inflation derivative contracts that are volatility transactions referencing interest rates of the same currency must be grouped together to form a hedging set;

(d) inflation derivative contracts that are volatility transactions referencing measures of inflation for the same currency must be grouped together to form a hedging set;

(e) non-inflation derivative contracts (other than basis transactions or volatility transactions) referencing interest rates of the same currency must be grouped together to form a hedging set; and

(f) inflation derivative contracts (other than basis transactions or volatility transactions) referencing measures of inflation for the same currency must be grouped together to form a hedging set.

(2) A derivative contract classified into a hedging set under subsection (1) must be further allocated into a maturity bucket in accordance with Table 23AA.

Table 23AA

Column 1 End date (E) applicable to a derivative contract	Column 2 Maturity bucket (MB_k)
< 1 year	k = 1
≧1 year and ≦5 years	k = 2
> 5 years	k = 3

(3) For the purposes of subsection (2), the value of E applicable to a derivative contract is determined in the same way as the value of E in Formula 23AZ in section 226BZC(2).

(4) In this section—

non-inflation derivative contract (非通脹衍生工具合約) means a derivative contract in the asset class of interest rate contracts that is not an inflation derivative contract.

226BN. Further classification of derivative contracts in asset class of exchange rate contracts

All derivative contracts in a netting set that fall within the asset class of exchange rate contracts must be further classified into different hedging sets as follows—

(a) volatility transactions referencing the same currency pair, or the same currency index, must be grouped together to form a hedging set; and

(b) contracts (other than volatility transactions) referencing the same currency pair, or the same currency index, must be grouped together to form a hedging set.

226BO. Further classification of derivative contracts in asset class of credit-related derivative contracts

(1) All derivative contracts in a netting set that fall within the asset class of credit-related derivative contracts must be further classified into different hedging sets as follows—

(a) basis transactions referencing the same pair of risk factors must be grouped together to form a hedging set;

(b) volatility transactions must be grouped together to form a hedging set; and

(c) all other contracts must be grouped together to form a hedging set.

(2) Derivative contracts classified into a hedging set under subsection (1) must be further classified into different subsets by grouping contracts within the hedging set that reference the same entity together to form a subset.

(3) For the purposes of subsection (2), a credit index is regarded as an entity and each separate credit index referenced by the derivative contracts must be treated as a separate entity.

226BP. Further classification of derivative contracts in asset class of equity-related derivative contracts

(1) All derivative contracts in a netting set that fall within the asset class of equity-related derivative contracts must be further classified into different hedging sets as follows—

(a) basis transactions referencing the same pair of risk factors must be grouped together to form a hedging set;

(b) volatility transactions must be grouped together to form a hedging set; and

(c) all other contracts must be grouped together to form a hedging set.

(2) Derivative contracts classified into a hedging set under subsection (1) must be further classified into different subsets by grouping contracts within the hedging set that reference the same entity together to form a subset.

(3) For the purposes of subsection (2), an equity index is regarded as an entity and each separate equity index referenced by the derivative contracts must be treated as a separate entity.

226BQ. Further classification of derivative contracts in asset class of commodity-related derivative contracts

(1) All derivative contracts in a netting set that fall within the asset class of commodity-related derivative contracts must be further classified into different hedging sets as follows—

(a) basis transactions referencing the same pair of risk factors must be grouped together to form a hedging set;

(b) volatility transactions must be assigned into one of the following hedging sets based on the underlying commodities of the transactions—

(i) energy;

(ii) metals;

(iii) agricultural products;

(iv) other commodities; and

(c) all other contracts must be assigned into one of the following hedging sets based on the underlying commodities of the contracts—

(i) energy;

(ii) metals;

(iii) agricultural products;

(iv) other commodities.

(2) Subject to subsection (3), derivative contracts classified into a hedging set under subsection (1) must be further classified into different subsets based on the type of underlying commodity into which the underlying exposures of the contracts fall.

(3) For the purpose of further classifying contracts in the hedging set of energy (mentioned in subsection (1)(b)(i) or (c)(i)) into different subsets under subsection (2), there must be at least the following 2 subsets—

(a) electricity;

(b) oil and gas.

(4) If the Monetary Authority considers that an authorized institution is significantly exposed to the basis risk resulting from different products within a hedging set or subset, the Monetary Authority may, by written notice given to the institution, require the institution to use more refined definitions of commodity types to define the subsets in the hedging set.

(5) An authorized institution must comply with the requirement of a notice given to it under subsection (4).

Subdivision 4—Calculation of Potential Future Exposure

226BR. Calculation of potential future exposure of netting set

(1) The potential future exposure of a netting set mentioned in section 226BC or 226BD is calculated by using Formula 23AM.

Formula 23AM

$$PFE = multiplier \cdot \sum_{a} AddOn^{(a)}$$

where—

(a) PFE is the potential future exposure of the netting set;

(b) multiplier is the amount calculated in accordance with subsection (3); and

(c) $AddOn^{(a)}$ is the add-on for derivative contracts in the netting set that fall within asset class a calculated in accordance with section 226BT.

(2) The potential future exposure of a netting set mentioned in section 226BF or 226BG is calculated by using Formula 23AM but $AddOn^{(a)}$ must be computed by—

(a) dividing the netting set into sub-netting sets such that—

(i) all margined contracts with the same margin period of risk are grouped together to form a sub-netting set; and

(ii) all unmargined contracts, if any, are grouped together to form a sub-netting set;

(b) calculating the add-on for derivative contracts in each of the sub-netting sets that fall within asset class a in accordance with section 226BT as if each of the sub-netting sets were a netting set; and

(c) aggregating all the add-ons obtained under paragraph (b).

(3) The multiplier in Formula 23AM is calculated by using Formula 23AN.

Formula 23AN

$$multiplier = \min\{1; Floor + (1 - Floor) \cdot A\}$$

$$A = \exp\left(\frac{V - C}{2 \cdot (1 - Floor) \cdot \sum_a AddOn^{(a)}}\right)$$

where—

(a) V and C have the same meaning as in Formula 23AB, 23AD, 23AH or 23AJ, as the case requires;

(b) Floor is 5%;

(c) exp (...) is the exponential function; and

(d) $AddOn^{(a)}$ has the same meaning as in Formula 23AM or subsection (2), as the case requires.

226BS. Calculation of potential future exposure of netting sets covered by same variation margin agreement

The potential future exposure of netting sets mentioned in section 226BE is calculated by using Formula 23AO.

Formula 23AO

$$PFE_{MA} = \sum_{NS \in MA} PFE_{NS}^{(unmargined)}$$

where—

(a) PFE_{MA} is the potential future exposure of all netting sets subject to variation margin agreement MA;

(b) $PFE_{NS}^{(unmargined)}$ is the potential future exposure of netting set NS calculated in

accordance with section 226BR(1) in a way as if netting set NS were not subject to any variation margin agreement; and

(c) $NS \in MA$ means netting set NS is covered by variation margin agreement MA.

Subdivision 5—Calculation of Add-on

226BT. Calculation of add-on for derivative contracts in same asset class

(1) The add-on for derivative contracts in a netting set that fall within the same asset class is calculated in accordance with subsection (2) or (3), as the case requires.

(2) If the asset class concerned is interest rate contracts, exchange rate contracts or commodity-related derivative contracts, the add-on must be calculated by using Formula 23AP.

Formula 23AP

$$AddOn^{(a)} = \sum_j AddOn_j^{(a)}$$

where—

(a) $AddOn^{(a)}$ is the add-on for derivative contracts in the netting set that fall within asset class a; and

(b) $AddOn_j^{(a)}$ is the add-on for derivative contracts in the netting set that fall within hedging set j in asset class a, calculated in accordance with section 226BU, 226BV or 226BY, as the case requires.

(3) Subject to subsection (4), if the asset class concerned is credit-related derivative contracts or equity-related derivative contracts, the add-on must be calculated by using Formula 23AQ.

Formula 23AQ

$$AddOn^{(a)} = \left[\left(\sum_k \rho_k \cdot AddOn(Entity_k)\right)^2 + I^{(a)}\right]^{0.5}$$

$$I^{(a)} = \sum_k \left(1 - (\rho_k)^2\right) \cdot \left(AddOn(Entity_k)\right)^2$$

where—

(a) $AddOn^{(a)}$ is the add-on for derivative contracts in the netting set that fall within asset class a;

(b) $AddOn(Entity_k)$ is the add-on for a subset of the derivative contracts that reference entity k calculated in accordance with section 226BW or 226BX, as the case requires; and

(c) ρ_k is the correlation factor applicable to entity k, which is—

(i) 50% if entity k is a single entity; or

(ii) 80% if entity k is an index.

(4) If the contracts falling within the asset class of credit-related derivative contracts or equity-related derivative contracts form more than one hedging set, an authorized institution must calculate a separate add-on for each of the hedging sets in accordance with subsection (3) as if a reference to netting set in that subsection were a reference to hedging set.

226BU. Calculation of add-on for hedging sets in asset class of interest rate contracts

(1) An authorized institution must calculate the add-on for a hedging set in the asset class of interest rate contracts by using Formula 23AR.

Formula 23AR

$$\text{AddOn}_j^{(IR)} = \text{SF}_j^{(IR)} \cdot \text{Effective Notional}_j^{(IR)}$$

where—

(a) $\text{AddOn}_j^{(IR)}$ is the add-on for hedging set j in the asset class of interest rate contracts;

(b) $\text{SF}_j^{(IR)}$ is the supervisory factor for hedging set j, which is, subject to adjustments set out in section 226BZ—

(i) 0.5% if hedging set j comprises interest rate contracts; or

(ii) 0.5% if hedging set j comprises inflation derivative contracts; and

(c) $\text{Effective Notional}_j^{(IR)}$ is the effective notional amount for hedging set j calculated in accordance with subsection (2).

(2) An authorized institution may use either Formula 23AS or Formula 23AT to calculate $\text{Effective Notional}_j^{(IR)}$ in Formula 23AR.

Formula 23AS

$$\text{Effective Notional}_j^{(IR)} = \left[\left(D^{(MB1)}\right)^2 + \left(D^{(MB2)}\right)^2 + \left(D^{(MB3)}\right)^2 + A\right]^{0.5}$$

$$A = 1.4 \cdot D^{(MB1)} \cdot D^{(MB2)} + 1.4 \cdot D^{(MB2)} \cdot D^{(MB3)} + 0.6 \cdot D^{(MB1)} \cdot D^{(MB3)}$$

Formula 23AT

$$\text{Effective Notional}_j^{(IR)} = \left|D^{(MB1)}\right| + \left|D^{(MB2)}\right| + \left|D^{(MB3)}\right|$$

where—

$D^{(MB1)}$, $D^{(MB2)}$ and $D^{(MB3)}$ are the effective notional amounts calculated in accordance with section 226BZA(2) respectively for maturity buckets 1, 2 and 3 (as allocated in accordance with section 226BM(2)) in hedging set j.

226BV. Calculation of add-on for hedging sets in asset class of exchange rate contracts

An authorized institution must calculate the add-on for a hedging set in the asset class of exchange rate contracts by using Formula 23AU.

Formula 23AU

$$\text{AddOn}_j^{(FX)} = \text{SF}^{(FX)} \cdot \left|\text{Effective Notional}_j^{(FX)}\right|$$

where—

(a) $\text{AddOn}_j^{(FX)}$ is the add-on for hedging set j in the asset class of exchange rate contracts;

(b) $\text{SF}^{(FX)}$ is the supervisory factor for the asset class of exchange rate contracts, which is equal to 4%, subject to

adjustments set out in section 226BZ; and

(c) $\text{Effective Notional}_j^{(FX)}$ is the effective notional amount for hedging set j calculated in accordance with section 226BZA(3).

226BW. Calculation of add-on for subsets in asset class of credit-related derivative contracts

(1) An authorized institution must calculate the add-on for derivative contracts in a subset (as classified in accordance with section 226BO(2)) in the asset class of credit-related derivative contracts by using Formula 23AV.

Formula 23AV

$$\text{AddOn}(\text{Entity}_k) = SF_k^{(Credit)} \cdot \text{Effective Notional}_k^{(Credit)}$$

where—

(a) $\text{AddOn}(\text{Entity}_k)$ is the add-on for a subset comprising contracts that reference entity k;

(b) $SF_k^{(Credit)}$ is the supervisory factor for entity k determined in accordance with subsection (2) or (3), subject to adjustments set out in section 226BZ; and

(c) $\text{Effective Notional}_k^{(Credit)}$ is the effective notional amount for contracts in the subset calculated in accordance with section 226BZA(4).

(2) For a contract referencing entity k (including a contract whose underlying exposure is a credit instrument issued by entity k or a credit-related derivative contract referencing entity k)—

(a) subject to paragraph (b), if entity k is a single entity, an authorized institution must—

(i) determine the credit quality grade applicable to the ECAI issuer rating of entity k or the long-term ECAI issue specific rating of the credit instrument, as the case may be, by mapping the rating to a scale of credit quality grades in accordance with Table A in Schedule 6 (regardless of whether entity k is a sovereign or not); and

(ii) determine the supervisory factor applicable to entity k by mapping the resultant credit quality grade to the corresponding supervisory factor in accordance with Table 23AB;

Table 23AB

Column 1 Credit quality grade	Column 2 Supervisory factor (%)
1	0.38
2	0.42
3	0.54
4	1.06
5	1.6
6	6.0

(b) if entity k referred to in paragraph (a) is a corporate incorporated in India, an authorized institution may—

(i) choose to determine the supervisory factor applicable to entity k by mapping the ECAI issuer rating of entity k or the long-term ECAI issue specific rating of the credit instrument, as the case may be, to a scale of credit quality grades in accordance with Part 2 of Table C in Schedule 6; and

(ii) determine the supervisory factor applicable to entity k by mapping the resultant credit quality grade to the corresponding supervisory factor in accordance with Table 23AC;

Table 23AC

Column 1	Column 2
Credit quality grade	Supervisory factor (%)
1	0.38
2	0.42
3	0.54
4	1.06
5 (and the ECAI rating is CARE BB-, CARE BB- (Is), CRISIL BB-, [ICRA] BB-, Ir BB- or above)	1.6
5 (and the ECAI rating is below CARE BB-, CARE BB- (Is), CRISIL BB-, [ICRA] BB- or Ir BB-)	6.0

(c) if neither ECAI issuer rating nor long-term ECAI issue specific rating is available for determination of the supervisory factor for entity k in accordance with paragraph (a) or (b), the supervisory factor applicable to entity k is 1.06%.

(3) For a contract referencing entity k (including a contract whose underlying exposure is a credit-related derivative contract referencing entity k), if entity k is an index, an authorized institution must—

(a) determine whether the index is an investment grade index or a non-investment grade index; and

(b) determine the supervisory factor applicable to entity k based on the type of index in accordance with Table 23AD.

Table 23AD

Column 1	Column 2
Type of index	Supervisory factor (%)
Investment grade index	0.38
Non-investment grade index	1.06

(4) For the purposes of subsection (3) and Table 23AD—

(a) an index is an investment grade index where the minimum credit rating specified by the index service provider concerned for the purpose of determining whether an entity is eligible for being included in the index, if mapped to a scale of credit quality grades in accordance with Table A, B or C of Schedule 6, as the case requires, would be mapped to a credit quality grade of 1, 2 or 3; and

(b) a non-investment grade index is an index that is not an investment grade index.

(5) An authorized institution must, in complying with subsection (2)(a) or (b) in relation to entity k, if there is more than one ECAI issuer rating or more than one long-term ECAI issue specific rating the use of which would result in the allocation by the institution of different supervisory factors to entity k, use any one of those ratings except the one or more of those ratings that would result in the allocation by the institution of the lowest of those different supervisory factors.

226BX. Calculation of add-on for subsets in asset class of equity-related derivative contracts

An authorized institution must calculate an add-on for derivative contracts in a subset (as classified in accordance with section 226BP(2)) in the asset class of equity-related derivative contracts by using Formula 23AW.

Formula 23AW

$$\mathrm{AddOn}(\mathrm{Entity}_k) = \mathrm{SF}_k^{(\mathrm{Equity})} \cdot \mathrm{Effective\ Notional}_k^{(\mathrm{Equity})}$$

where—

(a) $\mathrm{AddOn}(\mathrm{Entity}_k)$ is the add-on for a subset comprising contracts that reference entity k;

(b) $\mathrm{SF}_k^{(\mathrm{Equity})}$ is the supervisory factor for entity k which is, subject to adjustments set out in section 226BZ—

(i) 32% if entity k is a single entity; or

(ii) 20% if entity k is an index; and

(c) $\mathrm{Effective\ Notional}_k^{(\mathrm{Equity})}$ is the effective notional amount for contracts in the subset calculated in accordance with section 226BZA(4).

226BY. Calculation of add-on for hedging sets in asset class of commodity-related derivative contracts

An authorized institution must calculate the add-on for a hedging set in the asset class of commodity-related derivative contracts by using Formula 23AX.

Formula 23AX

$$\mathrm{AddOn}_j^{(\mathrm{Com})} = \left[\left(\rho^{(\mathrm{Com})} \cdot \sum_k \mathrm{AddOn}(\mathrm{Type}_k^j)\right)^2 + \mathrm{I}_j^{(\mathrm{Com})}\right]^{0.5}$$

$$\mathrm{I}_j^{(\mathrm{Com})} = \left(1 - \left(\rho^{(\mathrm{Com})}\right)^2\right) \cdot \sum_k \left(\mathrm{AddOn}(\mathrm{Type}_k^j)\right)^2$$

$$\mathrm{AddOn}(\mathrm{Type}_k^j) = \mathrm{SF}_k^{(\mathrm{Com})} \cdot \mathrm{Effective\ Notional}_k^{(\mathrm{Com})}$$

where—

(a) $\mathrm{AddOn}_j^{(\mathrm{Com})}$ is the add-on for hedging set j in the asset class of commodity-related derivative contracts;

(b) $\rho^{(\mathrm{Com})}$ is 40%;

(c) $\mathrm{SF}_k^{(\mathrm{Com})}$ is the supervisory factor for subset k (as classified in accordance with section 226BQ(2)) in hedging set j which is, subject to adjustments set out in section 226BZ—

(i) 40% if the type of the underlying commodity based on which the contracts are classified into the subset is electricity; or

(ii) 18% in any other case; and

(d) Effective $\text{Notional}_k^{(Com)}$ is the effective notional amount for contracts that fall within subset k in hedging set j calculated in accordance with section 226BZA(4).

226BZ. Treatments of supervisory factor for basis transactions and volatility transactions

The supervisory factor applicable to an asset class, a hedging set, a subset or an entity, when used in calculating the add-on for a hedging set in an asset class or for a subset in a hedging set, must be adjusted by multiplying the supervisory factor by—

(a) if the hedging set consists of basis transactions—one-half; or

(b) if the hedging set consists of volatility transactions—5.

Subdivision 6—Calculation of Effective Notional Amount

226BZA. Calculation of effective notional amount for hedging sets etc.

(1) The effective notional amount for each derivative contract is calculated by using Formula 23AY.

Formula 23AY

$$\text{Effective Notional} = \delta \cdot d \cdot MF^{(type)}$$

where—

(a) Effective Notional is the effective notional amount for a derivative contract;

(b) δ is the supervisory delta adjustment applicable to the contract determined in accordance with section 226BZB;

(c) d is the adjusted notional of the contract determined in accordance with section 226BZC; and

(d) $MF^{(type)}$ is the maturity factor for the contract determined in accordance with section 226BZD or 226BZE, as the case requires.

(2) The effective notional amount for a maturity bucket (as allocated in accordance with section 226BM(2)) in a hedging set in the asset class of interest rate contracts is the sum of the effective notional amounts calculated under subsection (1) for all the derivative contracts in the maturity bucket.

(3) The effective notional amount for a hedging set in the asset class of exchange rate contracts is the sum of the effective notional amounts calculated under subsection (1) for all the derivative contracts in the hedging set.

(4) The effective notional amount for a subset (as classified in accordance with section 226BO(2), 226BP(2) or 226BQ(2)) in the asset class of credit-related derivative contracts, equity-related derivative contracts or commodity-related derivative contracts is the sum of the effective notional amounts calculated under subsection (1) for all the derivative contracts in the subset.

(5) For the purposes of subsection (1), an authorized institution may approximate or replicate the payoff of a complex and non-linear derivative contract with a combination of simple derivative contracts if this is necessary in order to be able to calculate the effective notional amount of the complex and non-linear derivative contract by using Formula 23AY.

226BZB. Supervisory delta adjustment applicable to derivative contracts

(1) The supervisory delta adjustment (δ) applicable to a derivative contract that is not an option and does not provide tranched credit protection is determined in accordance with Table 23AE based on the type of derivative contract within which the contract falls.

Table 23AE

Column 1	Column 2
Type of derivative contract	δ
A derivative contract whose market value increases when the value of the contract's primary risk factor increases	+1
A derivative contract whose market value decreases when the value of the contract's primary risk factor increases	−1

(2) The supervisory delta adjustment (δ) applicable to a derivative contract that is an option is determined in accordance with Table 23AF based on the type of derivative contract within which the contract falls.

Table 23AF

Column 1	Column 2
Type of derivative contract	δ
Bought call option	$+N(+d)$
Sold call option	$-N(+d)$
Bought put option	$-N(-d)$
Sold put option	$+N(-d)$

(3) In Table 23AF—

(a) N(...) represents the cumulative distribution function for a standard normal random variable; and

(b) $$d = \frac{\ln\left(\frac{(P+\lambda)}{(K+\lambda)}\right) + 0.5 \cdot \sigma^2 \cdot T}{\sigma \cdot \sqrt{T}}$$

where—

(i) subject to subsection (4), P is the price of the underlying exposure of the option concerned (where appropriate, the forward value (rather than the spot price) of the underlying exposure is to be used to account for the risk-free rate as well as the possible cash flows generated from the underlying exposure prior to the option expiry);

(ii) K is the strike price of the option;

(iii) if the option falls within the asset class of interest rate contracts, λ is the presumed lowest possible extent to which the interest rates of the currency concerned can become negative, in any other case, λ is equal to zero;

(iv) σ is the supervisory volatility determined in accordance with Table 23AG based on the asset class (or subclass, where applicable) to which the option belongs; and

Table 23AG

Column 1	Column 2	Column 3
Asset class	Subclass	σ (%)
Interest rate contracts	-	50
Exchange rate contracts	-	15
Credit-related derivative contracts	Single-name	100
	Index	80
Equity-related derivative contracts	Single-name	120
	Index	75
Commodity-related derivative contracts	Electricity	150
	Commodities other than electricity	70

(v) T is the time period (measured in years) from the current date to the latest contractual or allowable exercise date of the option.

(4) For the purposes of subsection (3)(b), if the payoff of an option is determined by reference to the average price of the underlying exposure over a pre-specified period, P is the current value of the average price.

(5) The supervisory delta adjustment (δ) applicable to a derivative contract that provides tranched credit

protection is determined in accordance with Table 23AH based on the type of credit protection.

Table 23AH

Column 1	Column 2
Type of credit protection	δ
Purchased tranched credit protection	$+\frac{15}{(1+14\cdot A)\cdot(1+14\cdot D)}$
Sold tranched credit protection	$-\frac{15}{(1+14\cdot A)\cdot(1+14\cdot D)}$

where—

(a) A—

(i) in the case of a tranche of a securitization transaction—is the attachment point of the tranche;

(ii) in the case of a credit-related derivative contract referencing a basket of m reference entities where the nth default in the basket will trigger payment under the contract—is equal to (n – 1) divided by m;

(b) D—

(i) in the case of a tranche of a securitization transaction—is the detachment point of the tranche;

(ii) in the case of a credit-related derivative contract referencing a basket of m reference entities where

the nth default in the basket will trigger payment under the contract—is equal to n divided by m.

226BZC. Calculation of adjusted notional of derivative contracts

(1) Subject to subsection (5)—

(a) the adjusted notional of a derivative contract falling within the asset class of interest rate contracts or credit-related derivative contracts is the product of—

(i) the notional amount of the contract (converted to Hong Kong dollars at the current market spot exchange rate if it is not denominated in Hong Kong dollars); and

(ii) the supervisory duration of the contract calculated by using Formula 23AZ;

(b) the adjusted notional of a derivative contract falling within the asset class of exchange rate contracts is—

(i) the notional amount of the foreign currency leg of the contract, converted to Hong Kong dollars at the current market spot exchange rate; or

(ii) if both legs of the contract are denominated in currencies other than Hong Kong dollars—the notional amount of the leg that, after having been converted to Hong Kong dollars at the current market spot exchange rate, has the larger value; and

(c) the adjusted notional of a derivative contract falling within the asset class of equity-related derivative

contracts or commodity-related derivative contracts is—

(i) if the underlying exposure of the contract is an equity or a commodity—the product of the current market price of 1 unit of the equity or commodity and the number of units referenced by the contract;

(ii) if the underlying exposure of the contract is an index (including an index on volatility)—the product of the current level of the index and the value of each index point designated in the contract; or

(iii) if the contract is a volatility transaction—the product of the current value of the volatility measure specified in the contract and the contractual notional amount of the contract.

(2) The supervisory duration of a derivative contract falling within the asset class of interest rate contracts or credit-related derivative contracts is calculated by using Formula 23AZ.

Formula 23AZ

$$SD = \frac{\exp(-0.05 \cdot S) - \exp(-0.05 \cdot E)}{0.05}$$

where—

(a) SD is the supervisory duration of the contract, subject to a floor of 10 business days;

(b) subject to subsections (3) and (4), S is—

(i) subject to paragraph (ii), the time period (measured in years) from the

current date to the start date of the time period referenced by the contract; or

(ii) if the start date has passed—zero; and

(c) subject to subsections (3) and (4), E is the time period (measured in years) from the current date to the end date of the time period referenced by the contract.

(3) Subsection (4) applies if a derivative contract (***principal contract***) referred to in subsection (2)(b) or (c)—

(a) falls within the asset class of interest rate contracts and references the value of another interest rate contract, interest rate instrument, inflation derivative contract or inflation-linked instrument; or

(b) falls within the asset class of credit-related derivative contracts and references the value of another credit-related derivative contract or credit instrument.

(4) In determining the values of S and E in Formula 23AZ—

(a) subject to paragraph (c), if the principal contract references another derivative contract—references to the principal contract in paragraphs (b) and (c) of that formula is construed to mean the contract underlying the principal contract;

(b) subject to paragraph (c), if the principal contract references an instrument that is not a derivative contract—references to the principal contract in paragraphs (b) and (c) of that formula is construed to mean the instrument underlying the principal contract; or

(c) if the principal contract is an option on an interest rate swap and the option can be exercised on any one of a number of fixed and pre-determined exercise dates—

(i) S is the time period (measured in years) from the current date to the earliest allowed exercise date of the option; and

(ii) E is the time period (measured in years) from the current date to the end date of the time period referenced by the interest rate swap.

(5) If the notional amount of a derivative contract is not stated clearly or is not fixed until maturity, the notional amount to be used in the calculation of the adjusted notional of the derivative contract is—

(a) if the stated notional amount of the contract is a formula with market values as inputs—the amount calculated by entering the current market values into that formula;

(b) if the contract is structured so that its notional amount is variable over time—the time-weighted average notional amount over the remaining time to maturity of the contract;

(c) if the contract is leveraged by multiplying the rates referenced by the contract by a factor—the notional amount of the contract as if it were unleveraged which is calculated by multiplying the stated notional amount of the contract by the factor; or

(d) if the contract has multiple exchanges of principal—the product of the remaining number of exchanges of principal to be made under the contract and the stated notional amount of the contract.

226BZD. Maturity factor for unmargined contracts

(1) The maturity factor for an unmargined contract is calculated by using Formula 23AZA.

Formula 23AZA

$$MF_i^{(unmargined)} = \sqrt{\frac{\min\{M_i; 1\ year\}}{1\ year}}$$

where—

(a) $MF_i^{(unmargined)}$ is the maturity factor for unmargined contract i; and

(b) M_i is the remaining time to maturity of unmargined contract i (measured in years) from the current date, or, where applicable, the value as determined in accordance with subsection (2), (3) or (4), subject to a floor of 10 business days.

(2) If—

(a) the underlying exposure of an unmargined contract is another derivative contract (***underlying contract***); and

(b) the unmargined contract may be exercised or settled by physical delivery of the underlying contract,

the M_i of the unmargined contract for the purposes of Formula 23AZA is the time period from the current date to the final settlement date of the underlying contract.

(3) If—

(a) an unmargined contract is a derivative contract structured to settle the outstanding exposures under the contract on specified dates; and

(b) the terms of the contract are reset so that the fair value of the contract is zero on the specified dates,

the M_i of the derivative contract for the purposes of Formula 23AZA is the time period from the current date until the next reset date.

(4) If a derivative contract falls within paragraph (b) of the definition of ***unmargined contract*** in section 226BA, the M_i of the derivative contract for the purposes of Formula 23AZA is 10 business days.

226BZE. Maturity factor for margined contracts

(1) The maturity factor for a margined contract is calculated by using Formula 23AZB.

Formula 23AZB

$$MF_i^{(margined)} = \frac{3}{2}\sqrt{\frac{MPOR_i}{1\ year}}$$

where—

(a) $MF_i^{(margined)}$ is the maturity factor for margined contract i; and

(b) $MPOR_i$ is the margin period of risk appropriate for the variation margin agreement covering margined contract i, subject to the requirements set out in subsections (2), (3), (4), (5) and (6).

(2) Subject to subsections (3), (4) and (6) and unless otherwise required by Division 4, the margin period of risk applicable to a margined contract subject to daily remargining and daily mark-to-market must not be less than the following supervisory floor—

(a) 5 business days if the contract is a CCP-related transaction or an offsetting transaction in respect of a qualifying CCP entered into by an authorized institution—

(i) as a clearing member with its direct client; or

(ii) with a lower level client within a multi-level client structure associated with the qualifying CCP; or

(b) 10 business days in any other case.

(3) If a margined contract subject to daily remargining and daily mark-to-market is in a netting set referred to in section 226M(2), the margin period of risk applicable to the contract must not be less than the supervisory floor specified in that section.

(4) If a margined contract subject to daily remargining and daily mark-to-market is in a netting set referred to in section 226M(3), the margin period of risk applicable to the contract must not be less than the supervisory floor specified in that section.

(5) If the remargining frequency of a margined contract is not daily, the margin period of risk applicable to the contract must not be less than the supervisory floor calculated by using Formula 23E in section 226M(6) with F in that formula construed to mean the supervisory floor that would be applicable to the contract, if it were subject to daily remargining, determined in accordance with—

(a) subsection (2);

(b) section 226M(2) under subsection (3); or

(c) section 226M(3) under subsection (4).

(6) If a margined contract is—

(a) one referred to in subsection (2), (3), (4) or (5); and

(b) in a netting set over which there has been more than 2 margin call disputes during the previous 2 quarters and the disputes have lasted longer than the margin period of risk applicable to the contract under that subsection,

the margin period of risk applicable to the contract for the subsequent 2 quarters must be at least double the supervisory floor that would be applicable to the contract, if there were no margin call dispute, under that subsection.".

76. Section 226D amended (calculation of IMM(CCR) risk-weighted amount at portfolio level under IMM(CCR) approach)

Section 226D(1)(a) and (b)—

Repeal

"OTC derivative transactions or credit".

77. Section 226I amended (treatments for certain derivative contracts)

(1) Section 226I—

Repeal

"must treat"

Substitute

"may treat".

(2) Section 226I(a)—

Repeal

"has been"

Substitute

"is".

78. Section 226J amended (treatments for transactions with specific wrong-way risk)

Section 226J(1)(a) and (2)—

Repeal

"credit derivative"

Substitute

"credit-related derivative".

79. Section 226K amended (treatments for margin agreements)

(1) Section 226K(1)(a), after "agreement;"—

Add

"or".

(2) Section 226K(1)—

Repeal paragraph (b).

(3) Section 226K(3)—

Repeal

"OTC derivative transactions, credit".

(4) Section 226K(3)(b)—

Repeal

"(within the meaning of section 51(1))"

Substitute

"(subject to adjustment set out in section 3 of Schedule 7)".

(5) After section 226K (4)—

Add

"(5) An authorized institution must, if it has posted unsegregated collateral to a counterparty under a margin

agreement for a netting set, take into account its exposure to the counterparty arising from the unsegregated collateral (***relevant exposure***) in the calculation of effective EPE under section 226F.

(6) For the purposes of subsection (5), if an authorized institution determines the effective EPE of the netting set in accordance with subsection (1)(a), the amount of its relevant exposure must be calculated in accordance with the requirements under section 71(2), 118(2), 163(2A) or 164(2)(b), as the case requires, instead of by using the internal model.

(7) To avoid doubt, an authorized institution must, for collateral posted by it for a netting set (whether the collateral is taken into account in the determination of the effective EPE of the netting set or not), hold regulatory capital for the credit risk or market risk, whichever is applicable, of the collateral itself calculated under Part 4, 5, 6, 7 or 8, as the case requires—

(a) as if it had not been posted as collateral; and

(b) if the collateral is held by another person, as if the collateral were held by the institution.".

80. Section 226L repealed (shortcut method)

Section 226L—

Repeal the section.

81. Section 226M amended (margin period of risk)

(1) Section 226M—

Repeal subsection (1)

Substitute

"(1) Subject to subsections (2), (3) and (7) and unless otherwise required by Division 4, if a netting set of an authorized institution is subject to a margin agreement and the transactions in the netting set are subject to daily remargining and daily mark-to-market, the supervisory floor of the margin period of risk used for calculating the default risk exposure in respect of the netting set is—

(a) 5 business days if the netting set consists of repo-style transactions only;

(b) 5 business days if the netting set is not a netting set referred to in paragraph (a) and only consists of CCP-related transactions or offsetting transactions in respect of a qualifying CCP entered into by the institution—

(i) as a clearing member with its direct client; or

(ii) with a lower level client within a multi-level client structure associated with the qualifying CCP; or

(c) 10 business days in any other case.".

(2) Section 226M(2)—

Repeal

"An authorized institution"

Substitute

"Unless otherwise required by Division 4, an authorized institution".

(3) Section 226M(3)(b)—

Repeal

"an OTC derivative transaction or credit"

Substitute

"a".

(4) Section 226M(4)(a)—

Repeal

"not an OTC derivative transaction or credit"

Substitute

"not a".

(5) Section 226M(4)(a)(ii)—

Repeal

", transaction".

(6) Section 226M(4)(a)(ii)—

Repeal

"an OTC derivative transaction or credit"

Substitute

"a".

(7) Section 226M(6), Formula 23E—

Repeal

"is applicable to the netting set"

Substitute

"would be applicable to the netting set if the netting set were subject to daily remargining".

82. Part 6A, Divisions 2A and 2B added

Part 6A, after Division 2—

Add

"Division 2A—Current Exposure Method

226MA. Application of Division 2A

This Division applies to an authorized institution that uses the current exposure method to calculate the default risk exposure in respect of derivative contracts.

226MB. Calculation of default risk exposure

(1) Subject to subsections (2) and (3) and section 226MC, an authorized institution must use Formula 23EA to calculate the default risk exposure in respect of a derivative contract.

Formula 23EA

$$\text{Default risk exposure} = \alpha \times (RC + PFE)$$

where—

(a) $\alpha = 1.4$;

(b) RC is the current exposure of the contract (if any collateral posted by the institution for the contract is unsegregated collateral, the current exposure of the contract must include the current market value of the collateral); and

(c) PFE is the potential future exposure of the contract calculated in accordance with section 226MD.

(2) If the premium for a sold option of an authorized institution has been fully paid upfront by the counterparty concerned, the amount of default risk exposure to the counterparty in respect of the option may be set to zero.

(3) If an authorized institution is the protection seller in respect of a credit-related derivative contract with periodic premium payments and the contract is not a sold option, the amount of default risk exposure to the protection buyer of the contract calculated under this section is capped at the amount of the unpaid premium under the contract.

226MC. Treatments for certain credit derivative contracts

An authorized institution may treat the default risk exposure in respect of a credit derivative contract as zero if—

(a) both of the following conditions are met—

(i) the contract is a credit default swap in which the institution is the protection seller;

(ii) a regulatory capital is held in respect of the risk-weighted amount calculated in accordance with Part 5 or 7 for the institution's exposure to the credit risk of the reference obligation underlying the swap; or

(b) both of the following conditions are met—

(i) the institution is the protection buyer in the contract;

(ii) the credit risk mitigation effect of the contract has been recognized and taken into account under Divisions 7 and 8 of Part 5 or Division 5 of Part 7, for the purpose of calculating the risk-weighted amount of the exposure to which credit protection is provided by the contract.

226MD. Calculation of potential future exposure of derivative contract

(1) The potential future exposure of a derivative contract is calculated by multiplying the notional amount of the derivative contract by the credit conversion factor applicable to the contract determined in accordance with Table 23AI based on the type of derivative contract within which the contract falls.

Table 23AI

Column 1	Column 2	Column 3
Item	Type of derivative contract	Credit conversion factor
1.	Interest rate contract—	
	(a) with a residual maturity of not more than 1 year;	0.5%
	(b) with a residual maturity of more than 1 year but not more than 5 years;	2%
	(c) with a residual maturity of more than 5 years	4%
2.	Credit-related derivative contract that references a single entity, or a single-name credit instrument, having category 1 credit quality grade—	
	(a) with a residual maturity of not more than 1 year;	0.5%

Column 1	Column 2	Column 3
Item	Type of derivative contract	Credit conversion factor
	(b) with a residual maturity of more than 1 year but not more than 5 years;	2.5%
	(c) with a residual maturity of more than 5 years	4.5%
3.	Credit-related derivative contract that references an investment grade index—	
	(a) with a residual maturity of not more than 1 year;	0.5%
	(b) with a residual maturity of more than 1 year but not more than 5 years;	2.5%
	(c) with a residual maturity of more than 5 years	4.5%
4.	Credit-related derivative contract that references a single entity, or a single-name credit instrument, having category 2 credit quality grade—	
	(a) with a residual maturity of not more than 1 year;	1.5%
	(b) with a residual maturity of more than 1 year but not more than 5 years;	7%

Column 1	Column 2	Column 3
Item	Type of derivative contract	Credit conversion factor
	(c) with a residual maturity of more than 5 years	12.5%
5.	Credit-related derivative contract that references a single entity that does not have any ECAI issuer rating or a single-name credit instrument that does not have any long-term ECAI issue specific rating—	
	(a) with a residual maturity of not more than 1 year;	1.5%
	(b) with a residual maturity of more than 1 year but not more than 5 years;	7%
	(c) with a residual maturity of more than 5 years	12.5%
6.	Credit-related derivative contract that references a non-investment grade index—	
	(a) with a residual maturity of not more than 1 year;	1.5%
	(b) with a residual maturity of more than 1 year but not more than 5 years;	7%

Column 1	Column 2	Column 3
Item	Type of derivative contract	Credit conversion factor
	(c) with a residual maturity of more than 5 years	12.5%
7.	Credit-related derivative contract that references a single entity, or a single-name credit instrument, having category 3 credit quality grade—	
	(a) with a residual maturity of not more than 1 year;	6%
	(b) with a residual maturity of more than 1 year but not more than 5 years;	26.5%
	(c) with a residual maturity of more than 5 years	47%
8.	Exchange rate contract	4%
9.	Equity-related derivative contract that references a single name	32%
10.	Equity-related derivative contract that references an index	20%
11.	Commodity-related derivative contract the underlying commodity of which is precious metal (including gold)	18%

Column 1	Column 2	Column 3
Item	Type of derivative contract	Credit conversion factor
12.	Commodity-related derivative contract the underlying commodity of which is electricity	40%
13.	Commodity-related derivative contract (other than those referred to in items 11 and 12)	18%
14.	Any other derivative contract not specified in items 1 to 13	the applicable CCF specified in Part 2 of Schedule 1 or, if no such CCF is specified, 40%

(2) For the purposes of subsection (1)—

(a) if the derivative contract is a contract to which section 226ME is applicable, the notional amount must be determined in accordance with that section; and

(b) the type of derivative contract within which a contract falls must be determined based on the contract's primary risk factor.

(3) For the purposes of items 3 and 6 in Table 23AI—

(a) an index is an investment grade index where the minimum credit rating specified by the index service provider concerned for the purpose of determining whether an entity is eligible for being included in the index, if mapped to a scale of credit quality grades in accordance with Table A, B or C of Schedule 6, as the case requires, would be mapped to a credit quality grade of 1, 2 or 3; and

(b) a non-investment grade index is an index that is not an investment grade index.

(4) For the purposes of items 2, 4 and 7 in Table 23AI, an authorized institution must determine whether a single entity or a single-name credit instrument has a category 1, 2 or 3 credit quality grade by mapping the ECAI issuer rating of the entity, or the long-term ECAI issue specific rating of the credit instrument, to a scale of credit quality grades in accordance with—

(a) unless paragraph (b) applies—Table A in Schedule 6 (regardless of whether the entity or issuer of the credit instrument is a sovereign or not); or

(b) if the entity is a corporate incorporated in India or the credit instrument is issued by such a corporate—Part 1 or 2 of Table C in Schedule 6, as the case requires.

(5) For the purposes of items 2, 4 and 7 in Table 23AI—

(a) a single entity, or a single-name credit instrument, has a category 1 credit quality grade if the ECAI rating concerned is mapped to a credit quality grade of 1, 2 or 3;

(b) a single entity, or a single-name credit instrument, has a category 2 credit quality grade if the ECAI rating concerned is mapped to—

(i) a credit quality grade of 4;

(ii) subject to subparagraph (iii), a credit quality grade of 5; or

(iii) in the case of an ECAI rating mapped in accordance with Part 2 of Table C in Schedule 6—a credit quality grade of 5 where the ECAI rating is CARE BB-, CARE BB- (Is), CRISIL BB-, [ICRA] BB-, Ir BB- or above; or

(c) a single entity, or a single-name credit instrument, has a category 3 credit quality grade if the ECAI rating concerned is mapped to—

(i) subject to subparagraph (ii), a credit quality grade of 6; or

(ii) in the case of an ECAI rating mapped in accordance with Part 2 of Table C in Schedule 6—a credit quality grade of 5 where the ECAI rating is below CARE BB-, CARE BB- (Is), CRISIL BB-, [ICRA] BB- or Ir BB-.

(6) Subject to subsection (7)(a), for the purposes of Table 23AI—

(a) the residual maturity of an interest rate contract that references the value of another interest rate contract (***underlying contract***) or interest rate instrument is the time period from the current date to the maturity date of the underlying contract or instrument; and

(b) the residual maturity of a credit-related derivative contract that references the value of another credit-related derivative contract (***underlying contract***) or

credit instrument is the time period from the current date to the maturity date of the underlying contract or instrument.

(7) If a derivative contract is structured to settle the outstanding exposures under the contract on specified dates and the terms of the contract are reset so that the fair value of the contract is zero on the specified dates, an authorized institution—

(a) must treat the residual maturity of the contract as the time period from the current date until the next reset date; and

(b) if the contract is an interest rate contract and its remaining time to final maturity is more than 1 year—must not apply a credit conversion factor of less than 2% to the contract.

226ME. Notional amount of certain types of derivative contracts

(1) Subject to subsections (2) and (3)—

(a) the notional amount of an exchange rate contract is—

(i) the notional amount of the foreign currency leg of the contract, converted to Hong Kong dollars at the current market spot exchange rate; or

(ii) if both legs of the contract are denominated in currencies other than Hong Kong dollars—the notional amount of the leg that, after having been converted to Hong Kong dollars at the current market spot exchange rate, has the larger value; and

(b) the notional amount of an equity-related derivative contract or a commodity-related derivative contract is—

(i) if the underlying exposure of the contract is an equity or a commodity—the product of the current market price of 1 unit of the equity or commodity and the number of units referenced by the contract;

(ii) if the underlying exposure of the contract is an index (including an index on volatility)—the product of the current level of the index and the value of each index point designated in the contract; or

(iii) if the contract is a volatility transaction—the product of the current value of the volatility measure specified in the contract and the contractual notional amount of the contract.

(2) For a derivative contract that has multiple exchanges of principal, the notional amount of the contract is the product of the remaining number of exchanges of principal to be made under the contract and the stated notional amount of the contract.

(3) If the stated notional amount of a derivative contract is leveraged or enhanced by the structure of the contract, the notional amount of the contract is the effective notional amount of the contract calculated by taking into account the effect of the leverage or enhancement, as the case requires.

226MF. Authorized institution to hold regulatory capital for credit risk or market risk of posted collateral

To avoid doubt, an authorized institution must, for collateral posted by it for derivative contracts (whether the collateral is included in the calculation under section 226MB or not), hold regulatory capital for the credit risk or market risk, whichever is applicable, of the collateral itself calculated under Part 5, 7 or 8, as the case requires—

(a) as if it had not been posted as collateral; and

(b) if the collateral is held by another person—as if the collateral were held by the institution.

Division 2B—Calculation of Default Risk Exposure in Respect of SFTs

226MG. Interpretation for Division 2B

In this Division—

principal amount (本金額)—

(a) if the asset concerned is measured at fair value—means the value of the asset determined in accordance with section 4A;

(b) if the asset concerned is not measured at fair value—means the book value of the asset.

226MH. Application of Division 2B

This Division applies to the following authorized institutions—

(a) an authorized institution that does not have an IMM(CCR) approval for SFTs;

(b) an authorized institution that has an IMM(CCR) approval for certain types of SFTs only; and

(c) an authorized institution that is permitted under section 10B(5), or has chosen under section 10B(7), to use the methods prescribed in this Division for certain SFTs.

226MI. Calculation of default risk exposures in respect of SFTs: general

(1) Subject to subsections (2) and (3), an authorized institution must calculate the default risk exposure in respect of its SFTs (whether booked in its banking book or trading book) that are not subject to the IMM(CCR) approach in accordance with section 226MJ, 226MK or 226ML.

(2) If an authorized institution uses the STC approach and the simple approach in its treatment of recognized collateral for any exposures that are not past due exposures, the institution must not take into account the effect of recognized netting in the calculation of default risk exposure in respect of the institution's SFTs booked in its banking book.

(3) If an authorized institution uses the BSC approach, the institution must not take into account the effect of recognized netting in the calculation of default risk exposure in respect of all the institution's SFTs.

226MJ. Calculation of default risk exposure in respect of repo-style transactions that are not nettable and margin lending transactions

(1) An authorized institution must calculate the default risk exposure in respect of each of the following SFTs in accordance with this section—

(a) a repo-style transaction that is not nettable;

(b) a nettable repo-style transaction for which—

(i) the institution is not permitted to take into account the effect of recognized netting in the calculation of default risk exposure because of section 226MI(2) or (3); or

(ii) the institution has chosen not to take into account the effect of recognized netting in the calculation of the default risk exposure in respect of the transaction; or

(c) a margin lending transaction.

(2) An authorized institution must treat all securities and money provided by it to a counterparty under an SFT as if they were a loan to the counterparty secured on the money and securities that are provided to, or to the order of, the institution under the SFT.

(3) Accordingly, the authorized institution must take the principal amount of the securities and the money provided by it as the amount of the default risk exposure in respect of the SFT.

226MK. Calculation of default risk exposure in respect of nettable repo-style transactions

(1) Subject to section 226ML, an authorized institution must calculate the default risk exposure in respect of its nettable repo-style transactions that do not fall within section 226MJ(1)(b) in accordance with this section.

(2) An authorized institution must not take into account the effect of recognized netting covering the institution's repo-style transactions in the calculation of the default risk exposure in respect of the transactions other than under this section.

(3) An authorized institution must calculate the default risk exposure in respect of nettable repo-style transactions entered into by the institution with a counterparty by using Formula 23EB.

Formula 23EB

$$E^* = \max\left\{0, \left[\sum E - \sum C + \sum (E_S \times H_S) + \sum (E_{fx} \times H_{fx})\right]\right\}$$

where—

(a) E^* is the default risk exposure;

(b) E is the current market value of all money and securities provided by the institution under the transactions;

(c) C is the current market value of all money and securities received by the institution under the transactions;

(d) E_S is the absolute value of the net position in the same securities;

(e) H_S is the standard supervisory haircut applicable to E_s (subject to adjustment set out in section 3 of Schedule 7);

(f) E_{fx} is the absolute value of the net position in a currency different from the settlement currency; and

(g) H_{fx} is the standard supervisory haircut applicable in consequence of a currency mismatch, if any, between the currency in which a net position is denominated and the settlement currency (subject to adjustment set out in section 3 of Schedule 7).

(4) In determining the values of H_s and H_{fx} in Formula 23EB, the minimum holding period applicable to the repo-style transactions is determined in the same way as set out in section 91(1), (2) and (3).

(5) An authorized institution—

(a) subject to paragraph (b), must net its nettable repo-style transactions booked in its banking book separately from netting its nettable repo-style transactions booked in its trading book and vice versa;

(b) may net repo-style transactions booked in its banking book with repo-style transactions booked in its trading book in respect of the same counterparty if—

(i) all those repo-style transactions are marked-to-market daily; and

(ii) all the securities received by the institution under all those repo-style transactions are recognized collateral (within the meaning of section 51(1)) falling within section 80(1)(a), (b) or (c).

226ML. Use of value-at-risk model instead of Formula 23EB in section 226MK

(1) This section applies to an authorized institution that is granted an approval under section 18(2)(a) by the Monetary Authority to use the IMM approach to calculate its market risk.

(2) The institution may apply to the Monetary Authority for an approval to use an internal model based on VaR (***VaR model***) as an alternative to the use of Formula 23EB in section 226MK for the purpose of calculating the institution's default risk exposure to a counterparty in respect of nettable repo-style transactions.

(3) Subject to subsections (4) and (5), the Monetary Authority must—

(a) determine the application by granting or refusing to grant the approval; and

(b) give a written notice of the decision to the institution.

(4) The Monetary Authority must refuse to grant the approval under subsection (3)(a) unless the institution satisfies the Monetary Authority of all of the following, for the VaR model in respect of which the approval is sought—

(a) the model will take into account any relationship between the value of money and securities provided by the institution and the value of money and securities received by the institution under nettable repo-style transactions, and, in particular in this regard, whether the values have a positive relationship or negative relationship or have no relationship at all;

(b) the quality of the model has proved acceptable under a back-testing that—

(i) uses data covering at least a one-year period; and

(ii) covers representative counterparty portfolios that have been chosen based on the sensitivity of the portfolios to the material risk factors and

correlations to which the institution is exposed;

(c) if the nettable repo-style transactions are subject to daily remargining, the model will assume a minimum holding period of 5 business days and that minimum holding period—

(i) will be subject to increase to the extent that the liquidity of the securities provided by way of collateral under those transactions is such that a longer minimum holding period should be assumed; and

(ii) will be increased in the way set out in section 226M(2) or (3), as the case requires, if those transactions constitute a netting set that falls within any of the descriptions in that section;

(d) if the nettable repo-style transactions are not subject to daily remargining, the model will assume a minimum holding period that is at least equal to the minimum holding period calculated by using Formula 23EC;

Formula 23EC

$$\text{Minimum holding period} = F + N - 1$$

where—

F = the minimum holding period determined in accordance with paragraph (c) as if the transaction were subject to daily remargining; and

N = actual number of days between each remargining of the transactions.

(e) the minimum holding period determined in accordance with paragraph (c) or (d), as the case requires, will be further increased in the way set out in section 226M(7) if the transactions concerned constitute a netting set that falls within that section.

(5) The Monetary Authority must, in deciding whether to grant approval under subsection (3)(a) in respect of a VaR model, take into account the requirements set out in Schedule 3.

(6) An authorized institution that is granted an approval under subsection (3)(a) must calculate the default risk exposure in respect of nettable repo-style transactions entered into by the institution with a counterparty that do not fall within section 226MJ(1)(b) by using Formula 23ED.

Formula 23ED

$$E^* = \max\left\{0, \left[\left(\sum(E) - \sum(C)\right) + \text{VaR output}\right]\right\}$$

where—

(a) E^* is the default risk exposure;

(b) E is the current market value of all money and securities provided by the institution under the transactions;

(c) C is the current market value of all money and securities received by the institution under the transactions; and

(d) VaR output is the VaR number generated by the VaR model in respect of the previous business day.

226MM. Supplementary provisions to sections 226MK and 226ML

For the purposes of sections 226MK and 226ML, securities received by an authorized institution under repo-style transactions may be included in the calculation under either of those 2 sections only if—

(a) for repo-style transactions booked in the institution's banking book—the securities are recognized collateral (within the meaning of section 51(1)) falling within section 80(1)(a), (b) or (c); and

(b) for repo-style transactions booked in the institution's trading book—the securities are eligible for being included in trading book and the securities are provided to the institution under arrangements that satisfy all the requirements of section 77 (other than the requirements of section 77(g) and (i)).".

83. Section 226N amended (transactions and contracts to be covered)

Section 226N—

Repeal

", credit derivative contracts and (if required by the Monetary Authority under section 10A(6)) SFTs, except the transactions and contracts"

Substitute

"and (if required by the Monetary Authority under section 10A(6)) SFTs, except the transactions".

84. Section 226P amended (advanced CVA method)

(1) Section 226P(4) and (5)—

Repeal

", (12)".

(2) Section 226P—

Repeal subsection (12).

(3) Section 226P(13)—

Repeal

"current exposure method or the methods referred to in section 10A(1)(b)"

Substitute

"SA-CCR approach or the methods set out in Division 2B of this Part".

(4) Section 226P(13)—

Repeal

"current exposure method or any of the methods referred to in section 10A(1)(b)"

Substitute

"SA-CCR approach or any of the methods set out in Division 2B of this Part".

85. Section 226S amended (standardized CVA method)

(1) Section 226S(1), Formula 23J, paragraph (c)—

Repeal

"IMM(CCR) approach, the current exposure method or the methods referred to in section 10A(1)(b)"

Substitute

"SA-CCR approach, the IMM(CCR) approach, the current exposure method or the methods set out in Division 2B of this Part".

(2) Section 226S(2A)—

Repeal paragraph (b)

Substitute

"(b) the method set out in section 226MJ to calculate the institution's default risk exposures in respect of SFTs,".

(3) Section 226S(2A), after "recognized collateral"—

Add

"received under the SFTs".

86. Section 226T amended (eligible CVA hedges)

Section 226T(6)(c), before "the IMM(CCR) approach"—

Add

"the SA-CCR approach,".

87. Section 226U amended (application of Division 4)

Section 226U(2)—

Repeal

everything before "are not subject"

Substitute

"(2) To avoid doubt, exposures of an authorized institution—

(a) to—

(i) CCPs;

(ii) clearing members;

(iii) direct clients; or

(iv) higher level clients or lower level clients within multi-level client structures; and

(b) arising from delayed or failed settlement of—

(i) cash transactions in securities (other than repo-style transactions), foreign exchange or commodities; or

(ii) cash-settled derivative contracts,".

88. Section 226V amended (interpretation of Division 4)

(1) Section 226V(1), definition of ***Basel CCR Rules***—

Repeal

everything after "set out in"

Substitute

"chapters CRE50, CRE51, CRE52, CRE53, CRE54 and CRE55 of the consolidated Basel Framework published by the Basel Committee in December 2019, as amended or supplemented from time to time;".

(2) Section 226V(1)—

Repeal the definition of *initial margin*

Substitute

"***initial margin*** (開倉保證金)—

(a) means the collateral posted—

(i) to a CCP by—

(A) a clearing member of the CCP;

(B) a direct client of a clearing member of the CCP; or

(C) an indirect client within a multi-level client structure associated with the CCP; and

(ii) to mitigate the potential future exposure of the CCP to the clearing member arising from the possible future change in the value of the transactions of any one or more of the parties referred to in subparagraph (i)(A), (B) and (C);

(b) if the collateral referred to in paragraph (a) exceeds the minimum amount that the clearing member, direct client or indirect client is required to post and the CCP or clearing member may, where appropriate, prevent the clearing member, direct client or indirect client from withdrawing the excess amount posted—includes the excess amount; and

(c) does not include—

(i) any default fund contributions made by the clearing member; and

(ii) any collateral posted by the clearing member, direct client or indirect client that can be used by the CCP to mutualize losses among clearing members;".

(3) Section 226V(1)—

Repeal the definition of *qualifying CCP*

Substitute

"***qualifying CCP*** (合資格 CCP) means—

(a) a CCP—

(i) that has been granted a licence by a regulator or overseer to operate as a CCP (including a licence granted by way of confirming an exemption) and is permitted by the regulator or overseer to operate as such with respect to products offered by the CCP;

(ii) that is based and prudentially supervised in a jurisdiction where the regulator or overseer has established, and publicly indicated that it applies to the CCP on a continuous basis, domestic rules and regulations that are consistent with the principles in the document entitled "Principles for financial market infrastructures" published by the Committee on Payments and Market Infrastructures and the Technical Committee of the International Organization of Securities Commissions, as in force from time to time;

(iii) that calculates and makes available, or makes available sufficient information for other relevant parties to calculate, the parameters specified in paragraphs 54.28 to 54.36 of the Basel CCR Rules in accordance with the methodology and requirements set out in those paragraphs, so that the CCP's clearing members are able to calculate the regulatory capital for their default fund contribution made to the CCP, and update the calculation at least quarterly and whenever there are material changes to the number of, or the level of exposure in respect of, cleared transactions or material changes to the financial resources of the CCP; and

(iv) that provides sufficient information in the manner specified in paragraphs 54.37, 54.38 and 54.39 of the Basel CCR Rules to its regulator or overseer, clearing members and the relevant banking supervisory authorities of the clearing members to enable them to review the calculations of the parameters referred to in subparagraph (iii) or the capital charge calculations performed by the clearing members; or

(b) a CCP regarded as a qualifying CCP under section 1 of Schedule 16.".

(4) Section 226V(1), Chinese text, definition of *證券委員會國際組織*—

Repeal

"作；"

Substitute

"作。".

(5) Section 226V(1)—

(a) definition of ***Committee on Payment and Settlement Systems***;

(b) definition of ***offsetting transaction***;

(c) definition of ***variation margin***—

Repeal the definitions.

(6) Section 226V(1)—

Add in alphabetical order

"***Committee on Payments and Market Infrastructures*** (支付及市場基礎設施委員會) means the international standard setter, whose secretariat is hosted by the Bank for International Settlements in Basel, Switzerland, that promotes, monitors and makes recommendations about the safety and efficiency of payment, clearing, settlement and related arrangements, with a view to supporting financial stability and the wider economy;".

(7) Section 226V(2)(b)—

Repeal

"to a netting agreement"

Substitute

"to an arrangement".

(8) Section 226V(2)(b)—

Repeal

"as a netting agreement"

Substitute

"as an enforceable arrangement".

89. Section 226W amended (calculation of credit risk exposures)

(1) Section 226W(1)—

Repeal

"An authorized institution must calculate its default risk exposure to a CCP, a clearing member or a client in respect of OTC derivative transactions, credit"

Substitute

"Subject to subsections (3), (6), (7) and (8), an authorized institution must calculate its default risk exposure to a CCP, a clearing member, a direct client, or a higher level client or lower level client within a multi-level client structure in respect of".

(2) Section 226W—

Repeal subsections (2) and (4).

(3) Section 226W—

Repeal subsection (5)

Substitute

"(5) In subsection (6)—

20-business day supervisory floor (20 個營業日的監管下限), in relation to the calculation of the default risk exposure of a large netting set, means the higher supervisory floor of 20 business days required under—

(a) section 91(2) (as applied by section 226MK and insofar as it relates to section 226M(2));

(b) section 226BZE(3);

(c) section 226M(2); or

(d) section 226ML(4)(c)(ii) (insofar as it relates to section 226M(2));

large netting set (大型淨額計算組合) means a netting set that falls within the description in section 226M(2).

(6) The 20-business day supervisory floor does not apply to an authorized institution using the SA-CCR approach, the IMM(CCR) approach or the method set out in section 226MK or 226ML in its calculation of the default risk exposure of a large netting set with a qualifying CCP if the netting set—

(a) does not contain illiquid collateral or transactions that cannot be easily replaced; and

(b) does not contain any disputed transactions.

(7) For the purpose of calculating the default risk exposures to CCPs arising from clearing of derivative contracts under section 226X or 226ZD, a minimum margin period of risk of 10 business days must be used.

(8) If a CCP retains the variation margin posted by an authorized institution against a transaction and the variation margin is not protected against the insolvency of the CCP, the minimum margin period of risk or the minimum holding period, as the case requires, used in

calculating the institution's default risk exposure in respect of the transaction is the lesser of—

(a) 1 year; or

(b) the remaining time to maturity of the transaction, subject to a floor of 10 business days.".

90. Section 226X amended (exposures of clearing members to qualifying CCPs)

(1) Section 226X(1)(b)—

Repeal

"its clients"

Substitute

"its direct clients".

(2) Section 226X(2A)—

Repeal paragraph (a).

(3) Section 226X—

Repeal subsections (4), (5) and (6)

Substitute

"(4) An authorized institution that is a clearing member of a qualifying CCP must use Formula 23K to calculate the regulatory capital for its default fund contribution (K_{AI}) made to the qualifying CCP.

Formula 23K

$$K_{AI} = \max\left(K_{CCP} \cdot \left(\frac{DF_{AI}^{funded}}{DF_{CCP} + DF_{CM}^{funded}}\right); 8\% \cdot 2\% \cdot DF_{AI}^{funded}\right)$$

where—

(a) K_{CCP} is the hypothetical capital requirement of the qualifying CCP calculated in accordance with the methodology and requirements set out in paragraphs 54.28 to 54.35 of the Basel CCR Rules for its default risk exposures to all of its clearing members and their direct clients and, unless otherwise specified by the Monetary Authority under subsection (5), the risk-weight assigned to the default risk exposures for the purpose of the calculation is 20%;

(b) DF_{AI}^{funded} is the funded default fund contribution made by the institution;

(c) DF_{CCP} is the qualifying CCP's funded own resources, including capital and retained earnings, which are contributed to the default waterfall, where these resources are junior to, or rank equally with, clearing members' funded default fund contributions; and

(d) DF_{CM}^{funded} is the total funded default fund contributions made by the clearing members of the qualifying CCP.

(5) The Monetary Authority may, by written notice to all authorized institutions, specify a risk-weight that is higher than 20%, or equal to 20% (if the risk-weight currently in use is higher than 20%), for the purpose of the calculation of K_{CCP} under paragraph 54.29 of the Basel CCR Rules if the Monetary Authority considers that the risk-weight specified is warranted by the overall credit quality of the clearing members of the qualifying CCP concerned.

(6) The effective date of the risk-weight specified under subsection (5) is to be a date not less than 2 months from the date on which the authorized institutions were notified.

(7) An authorized institution that is a clearing member of the qualifying CCP concerned must ensure that the risk-weight specified under subsection (5) and its effective date are communicated promptly to the person responsible for the calculation of the K_{CCP}.

(8) Subsections (4), (5), (6) and (7) apply subject to section 2 of Schedule 16.

(9) An authorized institution may assign a risk-weight of 0% to its funded default fund contribution made to the qualifying CCP, to the extent of the amount for covering settlement-risk-only products.

(10) Subsection (11) applies if the sum of—

(a) an authorized institution's risk-weighted amount of its default risk exposure to a qualifying CCP; and

(b) the risk-weighted amount of its default fund contribution made to the qualifying CCP,

is higher than the total risk-weighted amount (***latter amount***) that would be calculated for those same exposures if the qualifying CCP were a non-qualifying CCP.

(11) The latter amount must be used in the institution's capital adequacy ratio calculations.".

91. Section 226Y amended (provisions supplementary to section 226X(4))

(1) Section 226Y—

Repeal subsections (1) and (2).

(2) Section 226Y(3), after "K_{AI}"—

Add

"by using Formula 23K".

(3) Section 226Y—

Repeal subsections (4) and (5).

(4) After section 226Y(6)—

Add

"(7) This section applies subject to section 2 of Schedule 16.".

92. Section 226Z amended (exposures of clearing members to clients)

(1) Section 226Z, heading—

Repeal

"clients"

Substitute

"direct clients".

(2) Section 226Z(1)(a)—

Repeal

"clients arising from CCP-related transactions"

Substitute

"direct clients arising from CCP-related transactions or offsetting transactions".

(3) Section 226Z(1)(b)—

Repeal

"clients'"

Substitute

"direct clients'".

(4) Section 226Z(2)(b)—

Repeal

“for a derivative contract traded on an exchange, with its client under a bilateral agreement between the institution and its”

Substitute

“or offsetting transaction for a derivative contract traded on an exchange, with its direct client under a bilateral agreement between the institution and the”.

(5) Section 226Z(2)—

Repeal

“the client arising”

Substitute

“the direct client arising”.

(6) Section 226Z(2A)(a)—

Repeal

“client”

Substitute

“direct client”.

(7) Section 226Z(2A)(b)—

Repeal

“recognized collateral in respect of the institution’s default risk exposure to the”

Substitute

“a form of recognized credit risk mitigation in respect of the institution’s default risk exposure to the direct”.

(8) Section 226Z(2A), English text—

Repeal

“mitigating”

Substitute

“mitigation”.

(9) Section 226Z(2A)—

Repeal

“client arising”

Substitute

“direct client arising”.

(10) Section 226Z(2A)—

Repeal

“recognized collateral”

Substitute

“a form of recognized credit risk mitigation”.

(11) Section 226Z—

Repeal subsection (3)

Substitute

“(3) If, in calculating a default risk exposure to a direct client, an authorized institution has applied—

(a) a shorter margin period of risk determined in accordance with section 226BZE(2)(a) or 226M(1)(b); or

(b) a margin period of risk determined in accordance with section 226BZE(5) or (6), or section 226M(6) or (7), based on the shorter margin period of risk referred to in paragraph (a),

the reduced default risk exposure resulted from the use of a shorter margin period of risk under paragraph (a) or (b)

must also be used in the calculation of the CVA risk-weighted amount in respect of the direct client.".

(12) Section 226Z—

Repeal subsection (4).

93. Section 226ZA amended (exposures of clients to clearing members)

(1) Section 226ZA, heading—

Repeal

"clients"

Substitute

"direct clients".

(2) Section 226ZA(1)(a)—

Repeal

"client"

Substitute

"direct client".

(3) Section 226ZA(1)(b), after "CCP-related transaction"—

Add

"or an offsetting transaction".

(4) Section 226ZA(1)—

Repeal

"(3), (4) and (5)"

Substitute

"(3) and (4)".

(5) Section 226ZA(2)(a)—

Repeal

"client"

Substitute

"direct client".

(6) Section 226ZA(2)(b), after "CCP-related transaction"—

Add

"or offsetting transaction".

(7) Section 226ZA(3) and (4)—

Repeal

"section 226X(1), (2)"

Substitute

"sections 226W(6) and 226X(1), (2), (2A)".

(8) Section 226ZA—

Repeal subsection (5).

(9) Section 226ZA(6)—

Repeal

"(3), (4) and (5)"

Substitute

"(3) and (4)".

(10) Section 226ZA(6)(a)—

Repeal

"for the relevant transaction is identified by the CCP as a"

Substitute

"with the CCP for the relevant transaction is identified by the CCP as a clearing".

(11) Section 226ZA(6)(a)(ii) and (iii)—

Repeal

"clients"

Substitute

"direct clients".

(12) Section 226ZA(6)—

Repeal paragraph (b)

Substitute

"(b) the institution—

(i) has conducted a sufficient legal review and has a well-founded basis to conclude that, in the event of a challenge in a court of law or before an administrative authority, the relevant court or administrative authority would find that the arrangements referred to in paragraph (a) would be legal, valid, binding and enforceable under the relevant laws of the relevant jurisdictions; and

(ii) undertakes such further review as necessary to ensure continuing enforceability of the arrangements referred to in paragraph (a); and".

(13) Section 226ZA(6)(c)—

Repeal

"transaction with"

Substitute

"transaction between the CCP and".

94. Section 226ZB amended (exposures of clients to CCPs)

(1) Section 226ZB, heading—

Repeal

"clients"

Substitute

"direct clients".

(2) Section 226ZB(1)—

Repeal

"(2), (3) and (4), where an authorized institution is a"

Substitute

"(2) and (3), where an authorized institution is a direct".

(3) Section 226ZB(2)—

Repeal

"a qualifying CCP arising from the relevant transaction in accordance with section 226X(1), (2)"

Substitute

"the CCP arising from the relevant transaction in accordance with sections 226W(6) and 226X(1), (2), (2A)".

(4) Section 226ZB(3)—

Repeal

"section 226X(1), (2)"

Substitute

"sections 226W(6) and 226X(1), (2), (2A)".

(5) Section 226ZB—

Repeal subsection (4).

(6) Section 226ZB(5)—

Repeal

"(2), (3) and (4)"

Substitute

"(2) and (3)".

(7) Section 226ZB(5)—

Repeal

"for the relevant transaction is identified by the CCP as a"

Substitute

"with the CCP for the relevant transaction is identified by the CCP as a clearing".

95. Section 226ZBA added

After section 226ZB—

Add

"226ZBA. Exposure of authorized institution to higher level client or lower level client within multi-level client structure

(1) Subject to subsection (5), if an authorized institution within a multi-level client structure enters into an offsetting transaction or a CCP-related transaction with a higher level client or lower level client (***relevant client***) within the structure (***relevant transaction***), the institution must calculate the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of the relevant client arising from the relevant transaction in accordance with Division 3 and Part 4, 5 or 6, as the case requires.

(2) If the relevant transaction referred to in subsection (1) is entered into between the institution and the relevant client under a bilateral agreement for a derivative contract traded on an exchange, the institution must calculate the risk-weighted amount of its default risk exposure and CVA risk-weighted amount in respect of the relevant client arising from the derivative contract as if the derivative contract were an OTC derivative transaction.

(3) In calculating the default risk exposure to the relevant client referred to in subsection (1) or (2) where such client is a lower level client, if the CCP concerned is a qualifying CCP, section 226Z(3) applies to the institution's netting set with the lower level client as it applies to a clearing member's netting set with the clearing member's direct client.

(4) For the purposes of subsections (1) and (2), section 226Z(2A) applies to the collateral collected by the institution from a lower level client within the multi-level client structure that has been passed on to the CCP concerned to secure a transaction cleared by the CCP as if the collateral were collected by an authorized institution as a clearing member from the clearing member's direct client that has been passed on to a CCP.

(5) For a relevant transaction referred to in subsection (1) entered into by an authorized institution with a higher level client, the institution may calculate the risk-weighted amount of its default risk exposure to the higher level client arising from the relevant transaction—

(a) if all the conditions set out in section 226ZA(6), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution—in accordance with sections 226W(6) and 226X(1), (2), (2A) and (3) as if its default risk exposure were to the CCP; or

(b) if all the conditions set out in section 226ZA(6) (excluding the condition set out in section 226ZA(6)(a)(iii)), with all necessary modifications, are met for arrangements among the CCP, clearing member, all clients at levels higher than the institution within the multi-level client structure, and the institution—in accordance with sections

226W(6) and 226X(1), (2), (2A) and (3) as if its default risk exposure were to the CCP except that the applicable risk-weight must be 4% instead of 2%.".

96. Section 226ZD amended (exposures of clearing members to non-qualifying CCPs)

(1) Section 226ZD(1)(b)—

Repeal

"clients"

Substitute

"direct clients".

(2) Section 226ZD—

Repeal subsection (1A)

Substitute

"(1A) To avoid doubt, for the purposes of subsection (1), if there is recognized credit risk mitigation not included in the calculation of the default risk exposure to the non-qualifying CCP, the recognized credit risk mitigation may be taken into account in the calculation of the risk-weighted amount of the exposure only if this is conducted in accordance with Part 4.".

(3) Section 226ZD(2)—

Repeal

"subsection (3)"

Substitute

"subsections (3) and (5)".

(4) After section 226ZD(4)—

Add

"(5) An authorized institution may assign a risk-weight of 0% to its funded default fund contribution made to a non-qualifying CCP, to the extent of the amount for covering settlement-risk only products.".

97. Section 226ZE amended (treatment of posted collateral)

(1) Section 226ZE—

Repeal subsection (1)

Substitute

"(1) Subject to subsections (2), (3) and (4), if—

(a) an authorized institution has posted collateral to—

(i) a CCP;

(ii) a CCP's clearing member; or

(iii) a higher level client within a multi-level client structure; and

(b) the collateral is unsegregated collateral,

the institution must, in respect of the collateral, calculate the risk-weighted amount of its credit exposure to the person holding the collateral in accordance with Part 4, 5 or 6, as the case requires.".

(2) Section 226ZE(4)—

Repeal

"client of a clearing member of a CCP and has posted collateral for transactions with the"

Substitute

"direct client of a clearing member of a CCP, or is an indirect client within a multi-level client structure associated with a CCP, and has posted collateral for transactions cleared by the".

(3) Section 226ZE(4)(b)—

Repeal

"and the other clients of the clearing member"

Substitute

"', the clearing member's direct clients, and, if clearing of the transactions by the CCP involves a multi-level client structure, clients within the structure at levels higher than the institution and those clients' clearing clients (whether within the structure or not)".

(4) Section 226ZE—

Repeal subsections (5) and (6).

(5) Section 226ZE—

Repeal subsection (6A)

Substitute

"(6A) Subsections (1) and (2) do not apply to collateral posted by an authorized institution that is—

(a) included as part of a default risk exposure to a CCP under section 226V(2)(a); or

(b) included in the calculation of the default risk exposure to a CCP, clearing member or higher level client under Division 1A, 2, 2A or 2B.".

(6) Section 226ZE(7)—

Repeal paragraph (a)

Substitute

"(a) any unsegregated collateral posted by an authorized institution to a CCP, clearing member or higher level client (***concerned party***) must be risk-weighted in accordance with section 226X, 226ZA, 226ZB, 226ZBA or 226ZD, as the case requires, if the unsegregated collateral is—

(i) posted in respect of one or more than one CCP-related transaction or offsetting transaction or in respect of a transaction entered into by the institution as a direct client with a CCP; and

(ii) included as part of the institution's default risk exposure to the concerned party by virtue of Division 1A, 2, 2A or 2B or section 226V(2)(a); and".

98. Section 227 amended (interpretation of Part 7)

(1) Section 227(1), definition of ***principal amount***, paragraph (b), after "securitization exposure"—

Add

"(other than default risk exposure)".

(2) Section 227(1), definition of ***clean-up call***, paragraph (b)—

Repeal

"providing"

Substitute

"purchasing".

99. Section 230 amended (treatment of underlying exposures of eligible securitization transactions: general)

(1) Section 230(2)—

Repeal

"subsections (3)"

Substitute

"subsections (2A), (3)".

(2) Section 230(2)(b), after "section 231,"—

Add

"in calculating the risk-weighted amount under paragraph (a),".

(3) After section 230(2)—

Add

"(2A) If the credit risk mitigation used in an eligible synthetic securitization transaction for transferring the credit risk of the underlying exposures to other parties to the transaction is a recognized guarantee or a recognized credit derivative contract provided by an SPE in respect of which all the requirements set out in section 2(a) of Schedule 10 are satisfied—

(a) the treatment set out in subsection (2) is not applicable to the underlying exposures of the transaction; and

(b) subject to subsections (2B), (3), (4) and (5) and section 231, the originating institution may only—

(i) if the credit risk mitigation is not in the form of tranched credit protection—calculate the risk-weighted amount of the underlying exposures of the transaction in accordance with subsection (2)(a) and take into account the effect of the credit risk mitigation in the calculation in accordance with Divisions 9 and 10 of Part 4 regardless of whether the calculation is made in accordance with Part 4;

(ii) if the credit risk mitigation is in the form of tranched credit protection—

(A) decompose the underlying exposures of the transaction into a protected sub-tranche and an unprotected sub-tranche;

(B) calculate the risk-weighted amount of the protected sub-tranche in accordance with this Part as if it were a securitization exposure and take into account the effect of the credit risk mitigation in the calculation in accordance with Divisions 9 and 10 of Part 4 instead of Division 5 of this Part; and

(C) calculate the risk-weighted amount of the unprotected sub-tranche by using the SEC-IRBA, SEC-ERBA, SEC-SA or SEC-FBA, as the case requires, and in accordance with sections 240, 241 and 249, as if the unprotected sub-tranche were a securitization exposure.

(2B) For the purposes of subsection (2A)(b)(i) and (ii)(B)—

(a) the risk-weight applicable to the credit protection covered portion (within the meaning of section 51(1)) or the protected sub-tranche, as the case requires, is the weighted-average risk-weight of the SPE's assets determined under Part 4; and

(b) the amount of the credit protection covered portion or the protected sub-tranche, as the case requires, must not be larger than the current market value of the SPE's assets adjusted downwards by standard supervisory haircuts for volatility of the value of the assets and any currency mismatch subject to adjustment set out in section 92.".

(4) Section 230(3), (5) and (6)—

Repeal

"(1) or (2)"

Substitute

"(1), (2) or (2A)".

100. Section 231 amended (treatment of underlying exposures of eligible synthetic securitization transactions in case of maturity mismatch or call option)

(1) Section 231(1)(a), after "section 230(2)(b)"—

Add

"or (2A)(b)".

(2) After section 231(2)—

Add

"(2A) In applying subsection (2)(b) for the purposes of section 230(2A)(b), P in Formula 12 must be construed to mean the amount of the credit protection covered portion or the protected sub-tranche, as the case requires, referred to in section 230(2B)(b).".

(3) Section 231(3), after "section 230(2)(b)(ii)"—

Add

"or (2A)(b)".

101. Section 232 amended (treatment of expected losses and provisions in respect of underlying exposures)

Section 232(1)(b)—

Repeal

"230(1) or (2)"

Substitute

"230(1), (2) or (2A)".

102. Section 234 amended (measures for authorized institution providing implicit support)

Section 234(2)(a)—

Repeal

"230(1) and (2)"

Substitute

"230(1), (2) and (2A)".

103. Section 313 amended (counterparty credit risk)

(1) Section 313(2), after "buyer"—

Add

"or protection seller".

(2) Section 313—

Repeal subsections (3) and (4).

(3) Section 313(5)(b)—

Repeal

"the current exposure method or the IMM(CCR) approach"

Substitute

"the SA-CCR approach, the IMM(CCR) approach or the current exposure method".

104. Section 321 amended (counterparty credit risk)

(1) Section 321(2), after "buyer"—

Add

"or protection seller".

(2) Section 321—

Repeal subsections (3) and (4).

(3) Section 321(5)(b)—

Repeal

"current exposure method"

Substitute

"SA-CCR approach".

105. Schedule 1 amended (specification for purposes of certain definitions in these Rules)

Schedule 1—

Repeal

"& 182]"

Substitute

", 182 & 226MD]".

106. Schedule 1A amended (transactions and contracts not subject to CVA capital charge)

(1) Schedule 1A, section 1(a)—

Repeal

", credit derivative contracts and SFTs with a CCP"

Substitute

"and SFTs with a qualifying CCP".

(2) Schedule 1A, section 1—

Repeal paragraphs (b) and (c)

Substitute

"(b) OTC derivative transactions and SFTs with a clearing member of a qualifying CCP for which the risk-weighted amount of the default risk exposure incurred by an authorized institution as a direct client of the clearing member is calculated in accordance with section 226ZA(3) or (4) of these Rules;

(c) OTC derivative transactions and SFTs with a qualifying CCP for which the risk-weighted amount of the default risk exposure incurred by an authorized institution as a

direct client of a clearing member of the CCP is calculated in accordance with section 226ZB(2) or (3) of these Rules;

(ca) OTC derivative transactions and SFTs with a higher level client within a multi-level client structure associated with a qualifying CCP for which the risk-weighted amount of the default risk exposure incurred by an authorized institution within the structure to the higher level client is calculated in accordance with section 226ZBA(5) of these Rules;".

(3) Schedule 1A, section 1(d)(i)(A)—

Repeal

", credit derivative contracts".

(4) Schedule 1A, section 1(d)(i)(B)—

Repeal

", credit derivative contracts and SFTs that fall within paragraph (a), (b), (c)"

Substitute

"and SFTs that fall within paragraph (a), (b), (c), (ca)".

(5) Schedule 1A, section 1(e)—

Repeal

", credit derivative contracts and SFTs (other than those falling within paragraph (a), (b), (c)"

Substitute

"and SFTs (other than those falling within paragraph (a), (b), (c), (ca)".

(6) Schedule 1A, section 1(e)(i)—

Repeal

"or contracts".

(7) Schedule 1A—

Repeal section 2.

107. Schedule 2A amended (minimum requirements to be satisfied for approval under section 10B(2)(a) of these Rules to use IMM(CCR) approach)

(1) Schedule 2A, section 1(e)(ii)(A)—

Repeal

"226L(3) of these Rules) and variation margins (within the meaning of section 226V(1)"

Substitute

"226A of these Rules) and variation margins (within the meaning of section 226A".

(2) Schedule 2A—

Repeal section 7.

108. Schedule 3 amended (minimum requirements to be satisfied for approval under section 18 of these Rules to use IMM approach)

Schedule 3—

Repeal

"[ss. 18, 19, 97"

Substitute

"[ss. 18, 19, 226ML".

109. Schedule 4B amended (qualifying criteria to be met to be Additional Tier 1 capital)

Schedule 4B, Chinese text, section 3(2)—

Repeal

"由與某認可機構屬同一銀行集團的實體發行及"

Substitute

"向與某認可機構屬同一銀行集團的實體發行，並由該實體".

110. Schedule 4C amended (qualifying criteria to be met to be Tier 2 capital)

Schedule 4C, Chinese text, section 3(2)—

Repeal

"由與某認可機構屬同一銀行集團的實體發行及"

Substitute

"向與某認可機構屬同一銀行集團的實體發行，並由該實體".

111. Schedule 6 amended (credit quality grades)

Schedule 6—

Repeal

"[ss. 55, 59, 60, 61, 61A, 62, 79, 98, 99, 139"

Substitute

"[ss. 2, 55, 59, 60, 61, 61A, 62, 79, 98, 99, 139, 226BW, 226MD".

112. Schedule 7 amended (standard supervisory haircuts for comprehensive approach to treatment of recognized collateral)

(1) Schedule 7, heading—

Repeal

"**for Comprehensive Approach to Treatment of Recognized Collateral**".

(2) Schedule 7—

Repeal

"51, 86, 94 & 96]"

Substitute

"2, 51, 86, 92, 94, 163, 226BJ, 226K & 226MK]".

(3) Schedule 7, section 1—

Repeal

everything before "**Table**"

Substitute

"1. The standard supervisory haircuts for taking into account the volatilities of the values of exposures (including exposures in the form of unsegregated collateral posted) and collateral are set out in the Table.".

(4) Schedule 7, section 2—

Repeal paragraph (a)

Substitute

"(a) the haircuts may only be applied to an exposure or collateral—

(i) that is subject to—

(A) daily marking-to-market;

(B) daily revaluation; or

(C) daily marking-to-market and daily remargining; and

(ii) whose applicable minimum holding period or margin period of risk determined under these Rules is 10 business days;".

(5) Schedule 7, section 2—

Repeal paragraph (e)

Substitute

"(e) ***recognized collateral*** (認可抵押品)—

(i) unless subparagraph (ii) applies—means recognized collateral within the meaning of section 51(1) or recognized financial collateral within the meaning of section 139(1); or

(ii) in relation to the calculation of default risk exposure by using the SA-CCR approach or IMM(CCR) approach—means collateral referred to in section 226BJ(5) or 226H(3);".

(6) Schedule 7, after section 2—

Add

"3. The standard supervisory haircut must be adjusted by using Formula 33 if any of the following, determined under these Rules, is not 10 business days—

(a) the minimum holding period or the margin period of risk of the transaction giving rise to the exposure concerned;

(b) the minimum holding period or the margin period of risk of the transaction giving rise to the exposure secured by the recognized collateral concerned;

(c) the minimum holding period of the unsegregated collateral concerned.

Formula 33

Adjustment of Standard Supervisory Haircuts

$$H = H_{10} \times \sqrt{\frac{P}{10}}$$

where—

H = haircut applicable to an exposure or recognized collateral, as the case requires, capped at 100%;

H_{10} = standard supervisory haircut appropriate for the type of exposure or recognized collateral to which the exposure or recognized collateral belongs; and

P = the following, as the case requires, determined in accordance with these Rules—

(i) the minimum holding period or the margin period of risk of the transaction giving rise to the exposure or of the transaction giving rise to the exposure secured by the recognized collateral; or

(ii) the minimum holding period of the unsegregated collateral.".

113. Schedule 8 amended (credit quality grades for specialized lending)

Schedule 8—

Repeal

"[s."

Substitute

"[ss. 2 &".

114. Schedule 10 amended (requirements to be satisfied for synthetic securitization transaction to be eligible synthetic securitization transaction)

(1) Schedule 10—

Repeal

"[s. 229"

Substitute

"[ss. 229 & 230".

(2) Schedule 10, section 2—

Repeal paragraph (a)

Substitute

"(a) the SPE in the securitization transaction concerned may be recognized as a credit protection provider for the purposes of section 98 or 99 if—

(i) the SPE owns assets that fall within one or more than one category of asset specified in section 80(1)(a), (b) and (c) and none of the SPE's assets is a securitization exposure;

(ii) relevant legal documentation provides that the SPE's assets can be applied to pay any amounts that the SPE may become obliged to pay from time to time to the originating institution pursuant to the credit protection concerned;

(iii) there are no claims or contingent claims (other than those for administrative fees, operating expenses and other similar payments) that rank senior to, or equally with, the rights of the originating institution

receiving payments pursuant to the credit protection; and

(iv) the arrangements through which the security interests in the SPE's assets are granted for the benefit of the originating institution and the control procedures in place, if they were carried out by an authorized institution, would satisfy the requirements under section 77(a), (b), (c), (d), (e), (ea) and (f); and".

115. Schedule 11 amended (mapping of ECAI issue specific ratings into credit quality grades under SEC-ERBA)

Schedule 11—

Repeal

"[ss. 15B, 265"

Substitute

"[ss. 2, 15B, 265".

116. Schedule 16 added

After Schedule 15—

Add

"Schedule 16

[ss. 226V, 226X & 226Y]

Transitional Provisions for Banking (Capital) (Amendment) Rules 2020

1. CCP not using SA-CCR approach regarded as qualifying CCP in certain circumstances

(1) Subject to subsections (2) and (3), a CCP in a jurisdiction outside Hong Kong may be regarded as a qualifying CCP for the purposes of these Rules despite the fact that the CCP does not meet the description in paragraph (a)(iii) and (iv) of the definition of ***qualifying CCP*** in section 226V(1) of these Rules in that the CCP's exposure amount to its clearing members is calculated not by using the applicable SA-CCR method.

(2) Subsection (1) applies only if—

(a) except as mentioned in subsection (1), the CCP otherwise meets the description in the definition of ***qualifying CCP*** in section 226V(1) of these Rules;

(b) the CCP is a CCP in a jurisdiction in which the jurisdiction's SA-CCR rule is published on or before 30 June 2021; and

(c) the earliest date by which any bank subject to the jurisdiction's SA-CCR rule must begin to use the applicable SA-CCR method to calculate the exposure amount of counterparty default risk (***mandatory compliance date***) does not fall on a date before 1 July 2021.

(3) Subsection (1) ceases to apply to a CCP in a jurisdiction on the mandatory compliance date for the jurisdiction's SA-CCR rule.

(4) In this section—

(a) a CCP is a CCP in a jurisdiction if—

(i) the CCP's place of incorporation or equivalent location (in the case of a non-corporate entity) is the jurisdiction; or

(ii) where a branch of the CCP is involved—the branch is located in the jurisdiction;

(b) a law, regulation or directive (however described) of a jurisdiction to implement a calculation method for measuring counterparty default risk exposures of banks based on the standardized approach to counterparty credit risk, set out in the Basel CCR Rules (within the meaning given in section 226V(1)) (***Basel SA-CCR approach***), is the jurisdiction's SA-CCR rule;

(c) the Basel SA-CCR approach, or that approach as modified under a jurisdiction's SA-CCR rule, is the applicable SA-CCR method.

(5) For the purposes of subsection (2)(b), a jurisdiction's SA-CCR rule is regarded as having been published in the jurisdiction on the completion of the procedure required by the law of the jurisdiction for bringing into force the rule, regardless of whether the mandatory compliance date is specified.

2. Exposures of clearing members to CCP regarded as qualifying CCP

(1) If a CCP is regarded as a qualifying CCP under section 1, an authorized institution that is a clearing member of the CCP must calculate the regulatory capital for the default fund contribution made by the institution to the CCP in accordance with sections 226X(4) and (6) and 226Y of the pre-amended Rules (instead of sections 226X(4), (5), (6) and (7) and 226Y of these Rules).

(2) In this section—

pre-amended Rules (原有規則) means these Rules as in force immediately before 30 June 2021.".

Monetary Authority

2020

Explanatory Note

These Rules are made by the Monetary Authority under section 97C of the Banking Ordinance (Cap. 155) to amend the Banking (Capital) Rules (Cap. 155 sub. Leg. L) (***principal Rules***).

2. The main purpose of the Rules is to amend the principal Rules—

   (a) to provide for a new method for calculating the exposure amount of counterparty credit risk arising from derivative contracts, as set out in the document entitled "The standardised approach for measuring counterparty credit risk exposures" published by the Basel Committee on Banking Supervision (***Basel Committee***) in March 2014 (revised in April 2014); and

   (b) to provide for the revised capital treatment of default fund contributions and exposures in respect of access to central clearing services through multiple layers of intermediaries, as set out in the document entitled "Capital requirements for bank exposures to central counterparties" published by the Basel Committee in April 2014.

New method for calculating the exposure amount of counterparty credit risk arising from derivative contracts

3. Under the principal Rules as in force before the commencement of the Rules (***pre-amended Rules***), an authorized institution may calculate the exposure amount of counterparty credit risk arising from derivative contracts by using the current exposure method (***CEM***) or the internal models (counterparty credit risk) approach.

4. The Rules seek to introduce a new method, namely the standardized (counterparty credit risk) approach (***SA-CCR approach***), for calculating the exposure amount of counterparty credit risk arising from derivative contracts. The provisions relating to the SA-CCR approach are mainly set out in the new Division 1A of Part 6A of the principal Rules (see section 75 of the Rules).

5. Provisions in the pre-amended Rules relating to the CEM and to the calculation of the exposure amounts of counterparty credit risk arising from securities financing transactions are relocated to the new Divisions 2A and 2B of Part 6A of the principal Rules so that all provisions related to the calculation of exposure amounts of counterparty credit risk are set out in the same Part (see section 82 of the Rules).

Revised capital treatment of default fund contributions and exposures in respect of access to central clearing services through multiple layers of intermediaries

6. Division 4 of Part 6A of the pre-amended Rules sets out the capital requirement for an authorized institution's exposures arising from transactions cleared by a central counterparty (***CCP***).

7. The Rules seek to revise the capital requirement by—

   (a) replacing the existing method for calculating the capital charges of an authorized institution's exposures arising from its default fund contributions made to a qualifying CCP (***QCCP***) with a new approach under which the SA-CCR approach will be used to determine a QCCP's counterparty credit risk exposures to its clearing members;

   (b) setting a cap on an authorized institution's total capital charges for its exposures to a QCCP; and

   (c) introducing a multi-level client structure and laying down capital treatment of exposures between clients within the structure.

8. The main provisions are set out in sections 4, 87, 88, 89, 90, 91, 92, 93, 94, 95, 96, 97 and 116 of the Rules. In particular—

(a) the new section 2AA of the principal Rules added by section 4 of the Rules describes a multi-level client structure and provides for the interpretation of terms used in relation to a multi-level client structure; and

(b) the new Schedule 16 to the principal Rules added by section 116 of the Rules provides for a transitional arrangement for certain CCPs in case their counterparty credit risk exposures to clearing members are not calculated by using the SA-CCR approach.

Others

9. The Rules also amend the principal Rules to enhance clarity of certain provisions of the principal Rules, including amendments to refine the capital treatment under the securitization framework to reflect certain common practices relating to the origination of securitization transactions.

10. The Rules come into operation on 30 June 2021.