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BY E-MAIL

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Proposed Amendments to the Banking (Capital) Rules to Implement the Revised Credit Risk Framework and Output Floor under the Basel III Final Reform Package

1 Introduction

The Asia Securities Industry & Financial Markets Association (“**ASIFMA**”),¹ on behalf of its members, welcomes this opportunity to comment on the amendments to the *Banking (Capital) Rules (Cap. 155L)* (“**BCR**”)² proposed by the Hong Kong Monetary Authority (“**HKMA**”) to implement in Hong Kong³ the revised credit risk framework and output floor set out in the document issued by the Basel Committee on Banking Supervision (“**BCBS**”) entitled “*Basel III: Finalising post-crisis reforms*” (“**Basel III Final Reform Package**”).

¹ ASIFMA is an independent, regional trade association with over 160 member firms comprising a diverse range of leading financial institutions from both the buy and sell side, including banks, asset managers, law firms and market infrastructure service providers. Together, we harness the shared interests of the financial industry to promote the development of liquid, deep and broad capital markets in Asia. ASIFMA advocates stable, innovative, competitive and efficient Asian capital markets that are necessary to support the region’s economic growth. We drive consensus, advocate solutions and effect change around key issues through the collective strength and clarity of one industry voice. Our many initiatives include consultations with regulators and exchanges, development of uniform industry standards, advocacy for enhanced markets through policy papers, and lowering the cost of doing business in the region. Through the [GFMA](#) alliance with [SIFMA](#) in the United States and [AFME](#) in Europe, ASIFMA also provides insights on global best practices and standards to benefit the region.

² We understand that the HKMA issued a letter on 30 June 2022 to consult the Hong Kong banking industry on proposed amendments to the BCR to implement the Basel III Final Reform Package – credit risk and output floor. The HKMA’s proposed amendments to the BCR are contained in two Annexes, as described below.

Annex 1: The proposed amendments in Annex 1 relate to (i) Parts 1 and 2 of the BCR which contain definitions and provisions applicable to more than one credit risk calculation approach; and (ii) Parts 4, 5, 6A, 6B and 7 of the BCR, which deal with the revisions to the “standardized (credit risk) approach” under Part 4 and the “basic approach” under Part 5 of the BCR, together with some consequential changes to other Parts of the BCR arising from the revised credit risk framework under the Basel III Final Reform Package.

Annex 1 is available here: https://www.hkma.gov.hk/media/eng/regulatory-resources/consultations/Annex_1_ECAI_mapping_tables_20220630.pdf

Annex 2: The proposed amendments in Annex 2 relate to Part 6 of the BCR, which deal with the revisions to the “internal ratings-based approach,” and the addition of a new Part (to be added after Part 10) of the BCR to set out the requirements of the newly introduced output floor under the Basel III Final Reform Package.

Annex 2 is available here: https://www.hkma.gov.hk/media/eng/regulatory-resources/consultations/Annex_2_BCAR_2023_Credit_risk_20220630.pdf

³ Any reference in this letter to “Hong Kong” or “Hong Kong SAR” shall be construed as a reference to the “Hong Kong Special Administrative Region of the People’s Republic of China”.

We appreciate the work that the HKMA is completing in this area, and for the opportunity to respond to HKMA's proposed amendments to the BCR ("**Proposed BCR Amendments**").

We support finalisation of the BCBS post-crisis reforms and appreciate ongoing work by the HKMA to adopt the standards, which not only helped to improve the banking sector's ability to withstand shocks,⁴ but also helps ensure a level playing field for local and international banks. At the same time, we also advocate for lessons learnt from previous implementation phases of this important regulatory reform to be considered in future phases.

We would like to highlight that as discussions regarding implementation of the Basel III Final Reform Package continue to evolve globally, the comments provided by ASIFMA in this response to the Proposed BCR Amendments should not be considered as final. ASIFMA will continue to assess the Basel III Final Reform Package over the near term, and form our positions more fully. We would also request that the HKMA provide the opportunity for further consultation and analysis once there is more clarity on global implementation of the Basel III Final Reform Package. We also request that the HKMA consider international developments in this area and monitor the implementation status and timeline in other key jurisdictions.

Given the vital role banking plays in supporting Hong Kong's capital markets and the real economy, carefully designed implementation and calibration of the Basel III global capital and liquidity standards published by the BCBS ("**Basel III**") is essential to support sustained growth in Hong Kong and the surrounding region. We have set out in this letter some principles-based recommendations which we suggest the HKMA take into consideration in implementing the Basel III Final Reform Package, particularly in light of their complexity and susceptibility to give rise to cross-jurisdictional issues.

Besides principles-based recommendations, we also recommend some specific changes to the treatment of unrated corporate exposures under Proposed BCR Amendments which are designed to better align the BCR with emerging practices in other major jurisdictions and to create a more even playing field in the Hong Kong financial services sector.

2 Executive summary

In this letter, we like to make the following recommendations in relation to the Proposed BCR Amendments and the implementation of the Basel III Final Reform Package in Hong Kong:

- 2.1 Hong Kong's Basel III implementation timeline should be aligned with other major jurisdictions, and Basel III should *not* be implemented in Hong Kong earlier than such jurisdictions. Please refer to section 3 of this letter for a detailed discussion of this issue.
- 2.2 In deciding whether or not to exercise national discretion under the Basel III Final Reform Package, the HKMA should consider the *cumulative* impact of all instances where a more conservative capital treatment is adopted. Please refer to section 4 of this letter for a detailed discussion of this issue.
- 2.3 The HKMA should carefully consider the competitive and economic implications of the proposed treatment of unrated corporate exposures under the Proposed BCR Amendments, especially in light of alternative approaches proposed in other major jurisdictions. Please refer to section 5 of this letter for a detailed discussion of this issue.

⁴ This has been demonstrated by the sector's ability to withstand the COVID-19 pandemic thus far, although we recognise that the financial and economic effects of the pandemic have yet to be fully realised.

- 2.4 Cooperation between home and host jurisdictions on Basel III implementation should be strengthened. Please refer to section 6 of this letter for a detailed discussion of this issue.
- 2.5 The HKMA should escalate issues identified during local consultation and implementation processes to the BCBS as part of a review of international consistency in Basel III implementation. Please refer to section 7 of this letter for a detailed discussion of this issue.

3 Hong Kong's Basel III implementation timeline should be aligned with other major jurisdictions

It is important that international standards such as Basel III are implemented consistently across jurisdictions, enabling banks to operate on a global level playing field whilst also reflecting the specific financial and economic circumstances of Hong Kong and the surrounding region. Furthermore, it is important for globally active banks that international standards are implemented in a coordinated way, including following a consistent timeline across jurisdictions, transitional arrangements, and with a reasonable implementation and/or phase-in period for banks once the rulemaking process is finalised.

The Proposed BCR Amendments contemplate a 1 July 2023 effective date. This gives rise to concerns that Hong Kong's implementation timeline will be much earlier than the implementation timelines in other major jurisdictions such as the European Union ("EU"), the United Kingdom ("UK"), the United States ("U.S."), Switzerland and Japan. We mention these jurisdictions specifically because they are among the world's largest economies and the vast majority of global systemically important banks ("G-SIBs") are headquartered in one of these jurisdictions.

While it is widely recognised that the Hong Kong banking sector's resilience has greatly improved since the global financial crisis with the roll-out of the first phase of Basel III reforms, accelerated Basel III implementation relative to other major jurisdictions may prove detrimental to other policy objectives such as supporting the development of local financial markets or financing of the local and regional economies. Accelerated implementation would also likely come with higher implementation risks and potential calculation and reporting errors as international banks will not be able to fully leverage their group-wide operational and compliance solutions.

The industry is grateful for the original decision to defer global implementation of the Basel III Final Reform Package by one year to 1 January 2023 in order to provide banks and regulators with additional operational capacity to respond to the impact of the COVID-19 pandemic.⁵ Yet, that original deferral decision was made in March 2020, at the very beginning of the COVID-19 pandemic. A lot has happened during the past two-and-a-half years. Many jurisdictions in the region are still facing challenges presented by COVID-19 pandemic and its aftermath. In the meantime, almost all major jurisdictions are battling fresh challenges presented by inflation, rapidly rising interest rates, capital outflow pressures, recession, financial instability, climate change and growing domestic and geopolitical tensions.

In the face of these new and existing challenges, a large number of major jurisdictions have decided to further defer Basel III implementation in order to properly address more pressing domestic and international regulatory, financial, economic, social and political issues. For example, the EU has further deferred the effective date of EU rules to implement the Basel III Final Reform Package to 1 January 2025. According to EU authorities, "the extended implementation period will allow banks to

⁵ See Governors and Heads of Supervision announce deferral of Basel III implementation to increase operational capacity of banks and supervisors to respond to Covid-19 (27 March 2020), available at: <https://www.bis.org/press/p200327.htm>.

focus on managing financial risks stemming from the COVID-19 crisis and on financing the recovery, and give them enough time to adjust before the reform reaches its full effect.”⁶

Similarly, after “taking into account the **publicly-announced implementation timetables in other major jurisdictions**, and the need to provide firms with sufficient time to implement the final policies (emphasis added)”, the UK’s Prudential Regulation Authority has recently announced its intention to further defer Basel III implementation until 1 January **2025**.⁷ Likewise, Japan’s Financial Services Agency has further deferred Basel III implementation to 31 March **2025** for non-internationally active financial institutions that do not use the internal model-based approaches for measuring risks and to 31 March 2024 for those that do use internal model-based approaches for measuring risks.⁸ While the U.S. banking regulators have not formally announced their intention to further defer Basel III implementation, it has been reported that the Basel III Final Reform Package is unlikely to be implemented in the U.S. *earlier than* its implementation in the EU and Japan.⁹ Meanwhile, Mainland China has not yet finalised the rules to implement the Basel III Final Reform Package.

In light of the foregoing, the 1 January 2023 implementation date originally announced by the BCBS in April 2020 has become somewhat theoretical or hypothetical, since the *de facto* globally-agreed implementation timeline now appears to be **January 2025 or later**.

It is important for the HKMA to adjust Hong Kong’s implementation timeline for the Basel III Final Reform Package in order to support a level playing field for market participants and minimise unintended consequences of market fragmentation.¹⁰ Therefore, we respectfully request that the HKMA align with the *de facto* globally-agreed implementation timeline such that the Proposed BCR Amendments do *not* come into effect until January 2025 or later if the *de facto* globally-agreed implementation timeline is further deferred.

We also recommend that the HKMA closely monitor the adoption and implementation status of the Basel III Final Reform Package in other key jurisdictions before finalising the Proposed BCR Amendments. This would allow the implementation timing and substantive contents of the BCR to align, as closely as possible, with Basel III standards as implemented in other major jurisdictions.

3.1 Operational challenges presented by the current implementation timeline

Besides the strong desirability for Hong Kong *not* to implement Basel III earlier than other major jurisdictions, we also emphasize the need to reserve sufficient time for implementation and

⁶ See European Commission, *Questions and Answers on the Banking Package 2021* (27 October 2021), available at: https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_5386.

⁷ See UK Prudential Regulation Authority, *Implementation of Basel standards* (21 March 2022), available at: <https://www.bankofengland.co.uk/news/2022/march/implementation-of-basel-standards>.

⁸ See Financial Services Agency announcement dated 28 April 2022 (updated 30 May 2022), available at: <https://www.fsa.go.jp/news/r3/ginkou/20220428.html>

⁹ See Risk.net, *US banks anticipate delay to Basel III implementation* (2 May 2022), available at: <https://www.risk.net/regulation/7947246/us-banks-anticipate-delay-to-basel-iii-implementation>

¹⁰ As several jurisdictions have yet to fully implement the Basel III standards, this undoubtedly creates market fragmentation and disproportionate complexity in Hong Kong and the Asia Pacific region and encouraged short-term transfers of business between jurisdictions, as end-users sought to optimise positions. Thus, in order to ensure a level playing field while minimising fragmentation and market distortions, it is critical for remaining phases of Basel III to be carefully considered and adjusted at the international level, if adherence to the agreed timeline is not feasible by certain key markets. If regulators and supervisors are committed to addressing the challenges of market fragmentation, as set out recently in the FSB Report on Market Fragmentation (available at: <https://www.fsb.org/wp-content/uploads/P040619-2.pdf>), commitment to an internationally aligned implementation of Basel III and other globally agreed standards should be a core requirement.

operationalisation, given that the Basel III Final Reform Package is a significant operational undertaking. In this respect, we note that Basel III implementation and operationalisation will likely present a sizable drain on the already limited resources of the banking industry, external services providers and regulators. This is because Basel III competes with other important regulatory and policy agenda items such as regulatory margin requirements for non-centrally cleared derivatives and related legal documentation,¹¹ ongoing benchmark reforms and emerging issues relating to regional and global financial stability, digital technology, cybersecurity, climate change and sustainable finance. It is also highly likely that there will be a significant requirement of supervisory resources as banks seek the required supervisory approvals to fully operationalise Basel III. Financial stability concerns are also raised since banks may see initial increases in capital based on the new standardised approach if model approvals are not achieved in time.

In light of the foregoing, we recommend that the HKMA allow itself and the Hong Kong banking industry sufficient time to implement and operationalise the Basel III Final Reform Package in an orderly manner which does not detract from other important and competing regulatory and compliance priorities.

3.2 No accelerated implementation of the Output Floor

We emphasize the importance for both the substantive requirements and the phasing in of the output floor under the Basel III Final Reform Package (“**Output Floor**”) to be implemented consistently with other major jurisdictions to ensure comparability of regulatory capital outcomes and to avoid any instance where Hong Kong incorporated banks are disadvantaged compared to their international counterparts.

In this respect, ASIFMA is concerned that the accelerated phase-in arrangement of the Output Floor proposed by the HKMA will place Hong Kong incorporated authorised institutions (“**AIs**”) at a competitive disadvantage. Excerpted below is Table 4 (entitled “Output Floor Levels”) of the Proposed BCR Amendments, which sets out the HKMA’s proposed phase-in schedule for the Output Floor. To illustrate the significantly accelerated nature of this proposed arrangement, we insert two additional columns in the table which set out, respectively, the BCBS’s original phase-in schedule beginning on 1 January 2023 and the EU’s phase-in schedule beginning on 1 January 2025. As explained above, the EU’s phase-in schedule has become the *de facto* globally-agreed implementation timeline for the Basel III Final Reform Package.

As is evident from the table below, the HKMA’s proposed phase-in schedule for the Output Floor is not only at least two years ahead of the EU’s phase-in schedule, it is also more accelerated than the BCBS’s phase-in schedule. For example, throughout the two-year period from 1 January 2024 to 31 December 2025, the level of the Output Floor would be 65% in Hong Kong, while it is only 55% (during calendar year 2024) and 60% (during calendar year 2025) under the BCBS phase-in schedule and the Output Floor would not have even begun to apply in the EU until 1 January 2025 when it would begin at 50%.

We respectfully submit that Hong Kong’s accelerated phase-in schedule for the Output Floor is not justified and is inconsistent with the approach taken in other major jurisdictions such as the EU, UK and Japan. An accelerated implementation of the Output Floor in Hong Kong could potentially reduce the ability of Hong Kong incorporated AIs to lend to the real economy, disadvantaging the financial markets and economy in Hong Kong and surrounding regions considerably, especially at a time when the Hong Kong, regional and global economies are already facing significant challenges, headwinds and

¹¹ In relation to regulatory margin documentation, we note that Mainland China has recently become a clean netting jurisdiction, which means that many AIs will need to prepare, negotiate, enter into and operationalise a significant number of highly complex initial margin and variation margin documents with Mainland China-based counterparties. This is a significant documentation and operational exercise and is expected to take up significant industry resources given the large number of Mainland China-based counterparties that enter into derivatives transactions with AIs.

uncertainties. It should also be noted the accelerated phase-in arrangement had originally been proposed by the HKMA based on data from a quantitative impact study (“**QIS**”) conducted in 2019, which was before the COVID-19 pandemic and other major regional and global events. ASIFMA is supportive of a targeted refresh of the 2019 QIS, which would provide a clearer impact of the COVID-19 pandemic and other recent events on capital levels and liquidity as well as on the ability of Hong Kong’s banking sector to support the real economy.

Finally, we note that item 43 in the document published by the HKMA in October 2021 entitled “*Revisions / clarifications to policy proposals in consultation paper on ‘Implementation of the Basel III Final Reform Package’ (CP 20.02)*” (“**2021 Revisions and Clarifications**”)¹² states that “[t]he HKMA is of the view that any capital release arising from the application of a lower output floor level during the phase-in period should not be used by AIs for distributions.” This policy position effectively removes potential concerns that a *non*-accelerated phase-in schedule for the Output Floor in Hong Kong would somehow erode the regulatory capital base of Hong Kong incorporated AIs.

Table 4 – Output Floor Levels Date from which increasing output floor level is applicable	Output floor level (Hong Kong)	BCBS original phase-in schedule	EU phase-in schedule (being the <i>de facto</i> globally-agreed implementation timeline)
Between 1 July 2023 and 31 December 2023	60%	50% from 1 January 2023	Output floor is not applicable at all during 2023
Between 1 January 2024 and 31 December 2025	65%	55% from 1 January 2024 60% from 1 January 2025	Output floor is not applicable at all during 2024 50% from 1 January 2025
Between 1 January 2026 and 31 December 2027	70%	65% from 1 January 2026 70% from 1 January 2027	55% from 1 January 2026 60% from 1 January 2027
On or after 1 January 2028	72.5%	72.5%	65% from 1 January 2028 70% from 1 January 2029 72.5% from 1 January 2030

4 Exercise of national discretion and careful consideration of the cumulative impact of conservative approaches proposed by the HKMA

In the HKMA’s November 2020 consultation paper on implementation of the Basel III Final Reform Package (CP 20.02) (“**2020 Consultation Paper**”), the HKMA originally proposed not to exercise certain national discretion elements under the Basel III Final Reform Package.¹³ Furthermore, where a national

¹² Available at: https://www.hkma.gov.hk/media/eng/regulatory-resources/consultations/Public_website_Summary.pdf

¹³ For example, at paragraph 105 of the 2020 Consultation Paper, the HKMA declined to apply a transitional cap that limits the increase in risk-weighted assets (“**RWAs**”) resulting from the application of the Output Floor to 1.25 times of an AI’s RWAs calculated before the application of the Output Floor.

discretion element under the Basel III Final Reform Package presented the HKMA with two or more options, the HKMA also originally proposed, in some instances, to select the more conservative option which results in higher capital charges.¹⁴

The industry commented on the HKMA's positions regarding the exercise or non-exercise of national discretion elements in the 2020 Consultation Paper. We commend the HKMA for taking into account industry feedback and revisiting its original positions in a number of instances, as reflected in the 2021 Revisions and Clarifications.¹⁵ Having said this, we note that a number of other jurisdictions are intending or expected to make *full* use of the national discretions available under the Basel III Final Reform Package. Indeed, some additional national discretions are warranted under certain circumstances, and we recommend that consideration be given to the exercise of such discretions to support the risk sensitivity of the overall capital framework and avoid unintended consequences.

Even if adopting a more conservative approach than under the Basel III Final Reform Package were justified in the specific context of a *particular* risk-weight calibration or calculation methodology, we encourage the HKMA to consider the *cumulative* impact of all instances where a more conservative approach is adopted. After undertaking a holistic review of the cumulative effect of these proposed conservative approaches, the HKMA may well find that their combined regulatory impact is disproportionate to the risks undertaken by the Hong Kong banking sector, which may adversely affect the Hong Kong banking sector's global competitiveness and its ability to support the real economy in Hong Kong and surrounding regions.

5 Refining the Proposed BCR Amendments – treatment of unrated corporate exposures

Under the Proposed BCR Amendments, exposures to unrated corporates that are not “small businesses” would be subject to a risk-weight of 100% under the standardised approach, while exposures to unrated corporates that are “small businesses” will be subject to a risk-weight of 85%.¹⁶

5.1 Treatment of unrated corporate exposures in other major jurisdictions

The draft Basel III implementation rules published by the European Commission (“**EC**”) on 27 October 2021 (“**EU 2021 Banking Package**”) adopts a “hybrid approach” in respect of unrated corporate exposures, which would apply during the transitional period scheduled to end on 31 December 2032. Under the hybrid approach, unrated corporate exposures with a probability of default (“**PD**”) of 0.5% or less (which are deemed to be ‘Investment Grade’) will be subject to a preferential 65% risk-weight during

Similarly, at paragraph 45(v) of the 2020 Consultation Paper, the HKMA explained that “[i]n view of the relatively riskier nature of IPCRE exposures and in line with current approach under the existing STC, the HKMA does not intend to implement this national discretion.”

Likewise, at paragraph 45(vi) of the 2020 Consultation Paper, the HKMA stated that “[f]or simplicity, and given that credit risk associated with qualifying IPRRE exposure is inherently different from that associated with general RRE exposure, the HKMA does not consider it appropriate to implement this national discretion.”

¹⁴ For example, in relation to national discretion elements under the revised standardised approach to credit risk (“**SACR**”), paragraph 44 of the 2020 Consultation Paper stated that the HKMA “would propose to adopt the more conservative option in these other areas of national discretion which are more reflective of the risks involved.”

¹⁵ Examples include: (i) item 4 in the 2021 Revisions and Clarifications regarding the exercise of national discretion to allow the use of external ratings which incorporate assumptions of implicit government support for up to a period of five years; (ii) item 21 in the 2021 Revisions and Clarifications regarding the exercise of national discretion to allow banks to demonstrate whether sovereigns and public sector entities have legal powers to ensure completion of property under construction in their jurisdictions; and (iii) item 24 in the 2021 Revisions and Clarifications regarding the exercise of national discretion as set out in footnote 43 of CRE20.94 (*calculation of RWA for credit risk*) in the Basel Framework.

¹⁶ See item 50(2) in Annex 1, which sets out the Proposed BCR Amendments.

the transitional period. This favourable capital treatment would apply to all unrated corporates, irrespective of whether they are listed or not. According to the EC, since “[m]ost EU corporates . . . do not typically seek external credit ratings due to the cost of establishing a rating and other factors,” the hybrid approach is specifically designed to “avoid disruptive impacts on bank lending to unrated corporates and provide enough time to establish public and/or private initiatives aimed at increasing the coverage of credit ratings.”¹⁷

While a final decision on the treatment of unrated corporate exposures is not yet announced by the U.S. banking regulators, we expect them to assign a 65% risk-weight to such exposures, which means that both U.S. banks and EU banks would be able to offer loan facilities and other related services to unrated corporate customers while applying a preferential 65% risk-weight.

5.2 Relevant considerations for Hong Kong

The EU 2021 Banking Package would allow EU banks to apply materially lower risk-weights across significant tranches of their credit portfolios during a lengthy transition period that does not end for another decade. Compared to Hong Kong incorporated AIs that are subject to a much less favourable 100% / 85% standardised risk-weight under the Proposed BCR Amendments, EU banks and, potentially, U.S. banks will have a competitive advantage. This would also result in an unlevel playing field between banks in jurisdictions which: (i) allow the use of external ratings but do not materially depart from the BCBS standards on the treatment of unrated corporates, such as Hong Kong; (ii) depart from the BCBS standards, such as the EU; and (iii) do *not* allow the use of external ratings, such as the U.S. The practical effect of other measures contained in the EU 2021 Banking Package mean that the binding impact of the Output Floor may be eliminated altogether for EU banks,¹⁸ which further exacerbates the differences in capital requirements and risk-weightings across these three types of jurisdictions.

At present, particularly in the Asian markets, only a small portion of companies have external credit ratings despite the relatively high creditworthiness of many Asian companies. The fact that most corporate borrowers in Hong Kong are unrated means EU and, potentially, U.S. banks (many of which lend and provide financial services in Hong Kong through their Hong Kong branches which are not subject to the BCR) will have a significant competitive advantage over Hong Kong incorporated AIs. To quantify this competitive advantage, we note that Hong Kong incorporated AIs would be required to apply a 100% standardised risk-weight to unrated corporates that are not “small businesses”, while EU and, potentially, U.S. banks may only be required to apply a favourable 65% standardised risk-weight (or an even lower effective risk-weight if these banks are not subject to a binding Output Floor). This means that the standardized risk-weight applied by Hong Kong incorporated AIs (at 100%) could be 1.5 times higher than the standardized risk-weight applied by their EU and, potentially, U.S. counterparts (at 65% or lower). The resulting unlevel playing field may ultimately be reflected in increased costs for certain Hong Kong corporate end-users, which can have detrimental consequences in the current economic environment.

5.3 Recommendations for the HKMA in relation to unrated corporate exposures

We respectfully request that the HKMA carefully consider the competitive and economic implications of the proposed treatment of unrated corporate exposures under the Proposed BCR Amendments. We encourage the HKMA to consider alternative approaches to unrated corporate exposures in light of the proposed treatment in other major jurisdictions. For example, the HKMA may wish to consider

¹⁷ See EC, *Proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor*, at page 14, available at: https://eur-lex.europa.eu/resource.html?uri=cellar:14dcf18a-37cd-11ec-8daf-01aa75ed71a1.0001.02/DOC_1&format=PDF.

¹⁸ This means that the Output Floor would not be a ‘binding floor’ for many EU banks because their aggregate RWA calculated using internal models are expected to be higher than the product of: (i) their aggregate RWA calculated using standardised non-models-based approaches; and (ii) the relevant percentage level of the Output Floor.

introducing the EU's "hybrid approach" or making certain compensating adjustments to the Output Floor to neutralise the significant competitive disadvantage that would be faced by Hong Kong incorporated AIs.

Under the HKMA's proposed amendments to Part 4 of the BCR, as described in Item 47 (*bank exposures standardized credit risk assessment approach*) and Item 49 (*exposures to non-bank financial institutions*) of Annex 1, an AI must assign a credit assessment grade to an unrated exposure to a bank or a non-bank financial institution for the purposes of determining the applicable risk-weight. While we appreciate the general guidelines provided by the HKMA with reference to the BCBS's credit risk capital framework ("**CRE framework**"), we would be grateful if the HKMA can please provide further guidance on how these credit assessments should be performed. For example, where there is a lack of available information or data to perform the standardised credit risk assessment ("**SCRA**"), would an AI be able to apply a flat or uniform risk-weight or credit assessment grade for risk-weighting purposes?

6 Strengthen cooperation between home and host jurisdictions

As a leading international financial centre, Hong Kong is not only home to locally-headquartered banking groups, it is also an important host jurisdiction for many major global banking groups, including G-SIBs. We encourage greater cooperation between home and host jurisdictions to support the financial stability objective across jurisdictions, and to achieve balance and coordination between group and local requirements. Strong cooperation between home and host jurisdictions would ensure that certain requirements (e.g., the Output Floor) where adequate consolidated standards are already applied at the group level, are not duplicated at the local level. The U.S., for instance, has tailored proportionate prudential requirements for non-U.S. banking organisations by relying on compliance with international standards at the banking group level. We encourage policy makers and supervisors to leverage existing channels such as the Crisis Management Group or Supervisory Colleges, and work towards greater cooperation and coordination to achieve the objective of financial stability across jurisdictions.

7 International feedback loop

From a process perspective, during implementation of Basel III, we encourage key policy makers such as the HKMA to not only consult meaningfully with market participants, but to also escalate issues identified during local consultation and implementation processes to the BCBS as part of a review of international consistency in Basel III implementation, with a view to exploring potential changes to the measures to improve their efficiency. This would support the Financial Stability Board's agenda of avoiding harmful regulatory fragmentation and evaluation of the impact of reforms, while promoting the BCBS's objective of a full and consistent implementation of Basel III.

We welcome future development and calibration of the Basel capital framework's implementation under the Basel III Final Reform Package. However, in the interest of international consistency, we advocate for lessons learnt from previous implementation phases of this important regulatory reform to be considered in future processes for meaningful and informed dialogue around implementation, for a coordinated approach between jurisdictions and between regulators, and for the BCBS to ensure reforms are effectively implemented while minimising unintended consequences.

8 Conclusion

We reiterate the banking industry's embrace of the objectives set out in the Basel post-crisis reforms in increasing global financial stability, and improvements made to banks' abilities to withstand shocks due to the thoughtful implementation to date.

ASIFMA takes this opportunity to convey our support and desire for continued constructive and on-going dialogue between the HKMA and market participants to assist the HKMA in developing and finalising

the remaining elements of Basel III implementation, including working with the HKMA if it seeks opportunities to canvas planning and thinking on future prudential requirements and how they might interact with international capital markets, as well as the post-COVID recovery globally and in the region.

We look forward to continued engagement with the HKMA on the issues set out in this letter. If you have further questions or would otherwise like to follow up, please contact Diana Parusheva-Lowery, ASIFMA's Executive Director and Head of Public Policy and Sustainable Finance, at DParusheva@asifma.org or +852 9822 2340. We would also be happy to meet with you to discuss this letter if you deem it appropriate.

Sincerely,

A handwritten signature in black ink, appearing to read 'DParusheva', written in a cursive style.

Diana Parusheva
Executive Director, Head of Public Policy and Sustainable Finance
Asia Securities Industry & Financial Markets Association (ASIFMA)