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2 November 2023

Banking Policy Division
Hong Kong Monetary Authority
55/F, Two International Finance Centre
8 Finance Street, Central
Hong Kong

By email: SupervisoryPolicyManual@hkma.gov.hk

Dear Sir/Madam,

ASIFMA-ISDA response to consultation on the new Supervisory Policy Manual Modules MR-1 "Market Risk Capital Charge" and MR-2 "CVA Risk Capital Charge"

The Asia Securities Industry & Financial Market Association ("ASIFMA")[1] and the International Swaps and Derivatives Association, Inc. ("ISDA")[2] welcomes the opportunity to respond to the consultation by the Hong Kong Monetary Authority ("HKMA") on the new Supervisory Policy Manual ("SPM") Modules MR-1 "Market Risk Capital Charge" and MR-2 "CVA Risk Capital Charge".

We commend the continuous efforts by the HKMA to update its policies in line with updates on global standards set by international standard setters, specifically, the January 2019 revised Minimum capital requirements for market risk[3] as well as the July 2020 Targeted revisions to the credit valuation adjustment risk framework[4] issued by the Basel Committee and Banking Supervision ("BCBS"), and have set out our response below.

Clarification on reporting frequency
Our members would like clarity on the reporting frequency of the calculation of both the market risk capital charge as well as the CVA risk capital charge under the new frameworks.

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[1] ASIFMA is an independent, regional trade association with over 160 member firms comprising a diverse range of leading FIs 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] Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 77 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.

[3] https://www.bis.org/bcbs/publ/d457.htm

[4] https://www.bis.org/bcbs/publ/d507.htm

For reporting of the market risk capital charge, paragraph 1.5.1 of SPM MR-1 states that the new market risk capital framework will take effect on date t, no earlier than 1 January 2025. Prior to date t, all locally incorporated Authorized Institutions ("AIs"), other than those exempted in paragraph 1.4.3, will be required to calculate their market risk capital charge under the new framework from a date no earlier than 1 July 2024 on a quarterly basis for reporting purposes. We note that paragraphs 3.1.1 and 4.1.1 of SPM MR-1 state that an AI should calculate and report the capital charges under the standardised (market risk) approach ("STM") or the internal models approach ("IMA") to the HKMA on a monthly basis.

For reporting of the CVA risk capital charge, paragraph 1.5.1 of SPM MR-2 states that the new CVA risk capital framework will take effect on date t, no earlier than 1 January 2025. Prior to date t, all locally incorporated AIs are required to calculate their CVA risk capital charge under the new framework from a date no earlier than 1 July 2024 on a quarterly basis for reporting purposes. Paragraphs 2.1.1 and 3.1.1 of SPM MR-2 mention that an AI using the BA-CVA or SA-CVA should calculate and report the CVA risk capital charges to HKMA on a monthly basis.

Our members would like to clarify if the reporting frequency requirement of their market risk and CVA risk capital charges will be quarterly until date t where the new market risk and CVA risk capital frameworks take effect and the reporting frequency requirement will be monthly.

Implementation date for market risk and CVA risk

We strongly recommend the HKMA to delay the implementation date of the minimum regulatory requirement for the revised standards on market risk and CVA risk to 1 July 2025. This would align Hong Kong's implementation date with that of other major jurisdictions like the United Kingdom ("UK") and the United States ("US"). In the UK, the Prudential Regulation Authority ("PRA") issued a news release[5] on 27 September 2023 to announce their intention to delay the implementation date of the final Basel 3.1 policies by six months to 1 July 2025. This is aligned with the US Agencies' proposed implementation date of 1 July 2025, which was published[6] on 27 July 2023.

We would like to emphasise the importance of aligning the Basel III final reform implementation timeline with other major jurisdictions to ensure a level playing field for market participants and minimise any unintended consequences of market fragmentation. In particular, this is essential for locally incorporated international banks as they work closely with their parent firms incorporated in major jurisdictions when implementing the Basel III final reforms to ensure system and data consistency.

The delay to the implementation date of the minimum regulatory requirement for the revised standards on market risk and CVA risk would allow for a longer phase in period than 6 months for the transition of compliance with the reporting requirement to the minimum regulatory capital requirement. In our previous response[7] to HKMA's consultation on the implementation timeline of the Basel III final reform package, our members have requested for a 12 month phase in period to allow the industry sufficient time to implement and operationalise in an orderly manner.

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[5] https://www.bankofengland.co.uk/news/2023/september/timings-of-basel-3-1-implementation-in-the-uk

[6] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm

[7] https://www.isda.org/2023/09/04/hong-kong-52/

We would also welcome more certainty on the final implementation date as this will help the industry to ensure adequate resources are arranged for the revised timeframes.

Consideration of the close correlation between the HKD and the MOP
With respect to paragraph 3.3.35 of SPM MR-1 which states that no distinction is required between onshore and offshore variants of a currency for all foreign exchange delta, vega and curvature risk factors, our members recommend the HKMA to consider the close correlation between the Hong Kong dollar ("HKD") and Macao Pataca ("MOP") in its requirements for the computation of foreign exchange ("FX") capital requirements.

The MOP is 100-percent backed by FX reserves and the Monetary Authority of Macao ("AMCM") assures the full convertibility of the MOP into its reserve money i.e., the HKD at a fixed exchange rate of HKD1:MOP1.03[8]. Further, an analysis can be performed on the HKD and the MOP using market data over the last two years which results in a correlation of 99.7% due to the full convertibility at a fixed exchange rate.

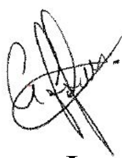
While the relationship between the HKD and the MOP could be recognised in the framework by introducing a reduced risk-weight in a way similar to the approach adopted for the HKD/USD currency pair, we note that the HKD/MOP currency pair is not subject to FX risks due to the fixed exchange rate. Treating the MOP as a foreign currency under the framework using a reduced risk-weight would likely still overestimate the FX risk capital requirements.

Further, the basis between the HKD and the MOP is expected to be lower than between onshore and offshore versions of a currency. To elaborate, the onshore and offshore variants of a currency exist because of exchange constraints while there is no exchange constraint for the HKD and the MOP as the currencies are fully convertible at a fixed exchange rate. The expected lower basis is also observed empirically where the correlation between the onshore and offshore versions of currencies is typically lower than that between the HKD and the MOP.

Therefore, we respectfully suggest for the HKMA to broaden paragraph 3.3.35 of SPM MR-1 to also include the HKD and the MOP pair as follows: "no distinction is required between onshore and offshore variants of a currency **<u>and between HKD and MOP</u>** for all foreign exchange delta, vega and curvature risk factors."

Thank you for your consideration of our members' feedback. Should the HKMA wish to discuss our response, please do not hesitate to contact the undersigned at dparusheva@asifma.org, gjones@isda.org, and speh@isda.org.

Yours sincerely,



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[8] https://www.amcm.gov.mo/en/about-amcm/history/the-pataca

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