Frequently Asked Questions on the CCyB

1. **Why does Hong Kong need to implement a CCyB? Does it benefit the banking sector / depositors?**

   - The CCyB is part of the internationally agreed Basel III standards. Hong Kong is implementing it in line with the Basel III implementation schedule.

   - The purpose of the CCyB is to increase the resilience of the banking sector against system-wide risks that tend to build up in sustained periods of fast credit growth. Banks will be required to build up a capital buffer during the upturn of a credit cycle, which can be used in the subsequent downturn to help maintain an adequate supply of credit to the real economy.

   - Depositors will benefit from a safer banking sector. Borrowers (including individuals and SMEs) can benefit from a more sustainable supply of credit in the longer run.

2. **Do you expect banks in Hong Kong will be under pressure to raise capital due to this new regulatory requirement?**

   - Banks in Hong Kong are well capitalized and already tend to hold a significant amount of buffer above their minimum capital requirements (some of which may be partly in preparation for the expected phase-in of the various Basel III buffer requirements). The new regulatory requirements are being phased in over a period of years and the HKMA does not expect that there will be substantial pressure on banks to raise equity or that major difficulties will be faced by the banking sector overall in meeting the requirements.

3. **Who decides on the construction of the IRC with the metric that takes into account local credit and domestic property market conditions? Is it a Basel Committee requirement? Does the Monetary Authority consider these the most pressing domestic risks?**

   - The Basel Committee requires every member jurisdiction to calculate and publish a Basel Common Reference Guide based on a credit/GDP gap measure (i.e. the deviation of the credit/GDP ratio from its long-term trend) and use it as a common starting point for decision making.

   - To cater for local circumstances, in addition to this Basel Common Reference Guide, the Monetary Authority has also designed the Initial Reference Calculator (IRC), which, in addition to incorporating the Basel Common Reference Guide, also synthesizes information on the credit market, the property market, the interbank market, and loan quality. Based on this information, the IRC produces an indicative buffer guide for the Hong Kong CCyB rate.

- Credit and property markets play central roles in the IRC because historically the two have played major roles in driving the financial cycle in Hong Kong. They have also proven to be relevant for providing early warning signals of potential banking system stress globally in other jurisdictions.

- The IRC serves as a starting reference point for the Monetary Authority in reaching his final decision, but the decision making process is not "mechanical" by reference to the IRC guide and the Monetary Authority will also utilize other relevant information and informed judgement. The information he uses in this context will depend on what he considers are the most pressing systemic risks in Hong Kong.

4. Do the indicators chosen suggest an assumption that the next crisis will start as a result of a real estate bubble? What if the source of the imbalance is elsewhere?

- By combining information on the degree to which <u>both</u> credit growth and property market valuations are deviating from their respective long-term trends, the IRC reflects the greater significance of the joint occurrence of large credit/GDP and property price/rent gaps in signalling the build-up of systemic risk as compared with the credit/GDP gap alone.

- Further, the Monetary Authority will be monitoring a range of other relevant indicators in addition to the credit/GDP gap and the property price/rent gap, to provide the best available picture of systemic conditions in Hong Kong. The monitoring techniques and methods will evolve over time in response to developments in the economy and innovations in the financial system.

5. Banks are required to fulfil the Basel III Capital Conservation Buffer, the CCyB and those banks to be designated as D-SIBs are also subject to an additional higher loss absorbency (HLA) capital surcharges in the first quarter of 2016. Will the cumulative effect of these new capital requirements be too harsh? Have banks complained that such cumulative requirements will stifle their business development?

- Although these three buffers serve different purposes and are set separately, both the CCyB and higher loss absorbency capital surcharges work as extension of the Capital Conservation Buffer.

- These buffers are expected to be set at appropriate levels depending (for the CCyB) on local macro-financial conditions or (for HLA) on the systemic importance of a bank.

- To mitigate the impact of their introduction, the buffers will be phased in gradually beginning in 2016 and will be fully implemented only on 1 January 2019.

- Given its strong capitalisation (average CET1 Ratio (13.5%) and Total Capital Ratio (16.4%) as at September 2014), the local banking sector is relatively well positioned to adopt the next phase of the Basel III capital standards without significant difficulty.

6. If by setting a CCyB our capital requirements are more stringent than in other jurisdictions, will this affect banks' desire to incorporate / do business in HK?

- Our requirement is consistent with the Basel framework and Basel Committee members include all of the major financial centres in the world.

- Furthermore, the reciprocity arrangements for the CCyB ensure that banks should not be able to avoid the buffer requirements by establishing in other jurisdictions. Under these arrangements, if a bank incorporated in another Basel Committee member jurisdiction lends into Hong Kong either via a branch or directly, its home supervisor there should apply the same Hong Kong CCyB rate on this bank's private sector credit exposures in Hong Kong, hence the opportunity for arbitrage is small.

7. How will you adjust the CCyB level in anticipation of the upcoming interest rate hikes? Or have these been reflected?

- The Monetary Authority takes a forward-looking view in determining the appropriate CCyB rate, and the implications of widely-expected macro scenarios (such as a forthcoming US interest rate hike) have been considered in assessing likely macro-financial conditions in Hong Kong.

8. Will local HK AIs be subject to buffers set by overseas authorities as well as to the HK buffer? What if an overseas authority sets a buffer at too high or too low a level?

- The Basel Committee has provided for jurisdictional reciprocity meaning that if a jurisdiction (Jurisdiction A) activates its CCyB, then other Basel Committee jurisdictions will require the banks incorporated in their jurisdictions to observe a buffer in respect of their exposures to Jurisdiction A at least as high as that set by the relevant authorities in Jurisdiction A, up to 2.5%.

- By default, AIs will be subject to buffers as set by overseas jurisdictions, up to 2.5%, starting 1 January 2016. However if an overseas buffer is below 2.5% the Monetary Authority has the ability under the Banking (Capital)

Rules to announce a higher CCyB requirement (up to 2.5%) for AIs in respect of an overseas jurisdiction in view of associated risk.

9. Why are three buffers needed? Why do we need the CCyB in addition to the capital conservation buffer and the HLA?

- Each of the three buffers serves a different purpose, and the combined level of the buffers will vary across AIs depending on their systemic importance and the systemic risk build-up in the regions where AIs operate.

- The capital conservation buffer of 2.5% (once fully phased in) should apply to all banks as a basic cushion against any unforeseen shocks.

- The HLA buffer will apply to those AIs whose failure could have a very significant adverse impact on the financial system and the broader economy. The purpose of the HLA is to reduce the likelihood of failure of such AIs.

- The CCyB rates will be higher for jurisdictions where excessive aggregate credit growth is judged to be associated with a build-up of system-wide risk. AIs with greater private sector credit exposure in such jurisdictions will be subject to higher CCyB requirements.

10. It seems all very complicated – why not just increase the minimum capital requirement?

- The minimum capital requirement is required to be maintained throughout the ups and downs of a financial cycle, and should never be breached. The purpose of the CCyB, in contrast, is to help AIs build up buffers during good times, which can be used during the financial cycle downturns that typically follow a period of elevated credit growth. The buffer can absorb losses in the downturn and help maintain the flow of credit to the real economy.

11. When will you announce the list of D-SIBs?

- The Monetary Authority is currently finalising the D-SIB assessment methodology, having consulted the industry and currently expects that the D-SIB designation process should be completed within Q1 2015.