THE
HONG KONG
ASSOCIATION
OF
BANKS
香港銀行公會

Room 525, 5/F., Prince's Building, Central, Hong Kong
Telephone: 2521 1160, 2521 1169 Facsimile: 2868 5035
Email: info@hkab.org.hk Web: www.hkab.org.hk

香港中環太子大廈5樓525室
電話：2521 1160, 2521 1169 圖文傳真：2868 5035
電郵：info@hkab.org.hk 網址：www.hkab.org.hk

15 April 2010 (By email: baselcommittee@bis.org & post)

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

Dear Sirs,

**Consultative proposals to strengthen the resilience of the banking sector**

We refer to the Consultative documents to strengthen the resilience of the banking sector, "Strengthening the resilience of the banking sector" and "International framework for liquidity risk measurement, standards and monitoring" ("Consultative Documents") published by the Basel Committee on Banking Supervision ("BCBS") in December 2009. On behalf of our members, we set out our views on various proposals in the Consultation Documents:

**General comment**

We welcome the consultation process on BCBS's proposal to strengthen global capital and liquidity regulations with the goal of promoting a more resilient banking sector. We recognize the need to improve the banking sector's ability to absorb shocks arising from financial and economic stress, thus reducing the risk of spill over from the financial sector to the real economy.

We believe that the package of proposals places too much emphasis on the desirability of maintaining very high levels of capital. We are concerned that while a number of the proposals are sensible, the combined effects of these proposals might not be able to address the underlying causes of the financial crisis, including inadequate balance sheet and liquidity management, poor risk management practices and ineffective regulatory oversight.

While we generally support the need for reform, we consider that the potential impacts are difficult to evaluate at this stage of the consultative process, as in some cases the proposed changes are complex or are still at a conceptual level. We are keen to ensure that the cumulative impacts of all proposals are assessed and calibrated accordingly to ensure that there is no double counting of capital requirements. We therefore would like to recommend that BCBS allows the banking

industry sufficient opportunity to discuss with regulators the results of the Quantitative Impact Study ("QIS") before proposals are finalized by the BCBS.

It is also important that the measures eventually introduced are implemented on an internationally consistent basis to maintain a level playing field and avoid regulatory arbitrage, and for this to be achieved, there needs to be a balance between introducing more regulation and increasing the complexity of regulation. We advocate a measured and straightforward approach that addresses the key issues identified by the financial crisis.

We appreciate BCBS's plans to conduct a QIS to assess the impact on banks which will be used as a basis for calibrating the total level and quality of capital and liquidity. We also feel that it is important for BCBS to include a top-down evaluation of the likely impact of the proposals on areas including, but not restricted to, the availability and cost of credit, availability of and demand for liquid securities, competition for deposits, lending capacity, demand for capital and its impact on the equity markets, and how all of these will affect employment and the real economy. In addition, the proposals have to be considered in the context of the unprecedented levels of government intervention during the financial crisis and the need to recognise the impact of unwinding the various guarantee and special liquidity schemes operated by governments and central banks in many countries.

Our comments on the specific proposals in each consultative document are listed below.

## A) Consultative document – <u>Strengthening the resilience of the banking sector</u>

### 1. <u>Consistency and international harmonization</u>

Overall, we support the view that the banking system does require higher levels of capital, and that the quality of this capital needs to be improved to ensure that it is able to absorb losses to a greater extent.

However, the proposals must be applied consistently across countries, with very limited scope for national discretion. This is not always the approach adopted in the proposals. An example would be the section on capital buffers which states that "The framework would be applied at the consolidated level, i.e. restrictions would be imposed on distributions out of the consolidated group. National supervisors would have the option of applying the regime at the solo level to conserve resources in specific parts of the group." The BCBS should require consistent regulation at either the consolidated level, solo level or both. There is already evidence of differing levels of bank regulation in different countries. The BCBS should take the opportunity that the current crisis has presented to

promote international harmonization, and reduce the risk of regulatory arbitrage. It is further noted that Basel II has still to be implemented in many countries and there is now a diverse set of regulations being applied globally.

## 2. Grandfathering and transition arrangements

The document sets out various proposals to strengthen the definition of capital, focusing on its overall quality, consistency and transparency, including:

- Separate sets of criteria for instruments that qualify as Tier 1 Capital – common equity, Tier 1 Capital – Additional Going-Concern Capital and Tier 2 Capital
- Limits and minima applied to the different components of capital
- Regulatory adjustments applied to the different elements of capital

Given the significant changes proposed to the definition of capital which now place more emphasis on Tier 1 common equity, we are concerned that the higher demands for equity capital in the banking industry will increase the cost of, and demand for, equity significantly with a major impact on equity markets and, consequently, on the real economy. Therefore, we strongly recommend that there must be appropriate "grandfathering and transitioning provisions": capital instruments which have already been issued by banks prior to the finalisation of this document should be grandfathered.

Also, BCBS should set out clearly the degree & applicability of the grandfathering provisions for both capital and regulatory adjustments such as 'deductions'.

Finally, the timelines for the implementation of these changes should be extended in order to prevent a sudden destabilising rush to the equity markets, something that would reduce the amount of capital available to all businesses, thus impacting both investor confidence and the real economy adversely.

## 3. Minority interest

While we generally agree with the proposition that minority interest is not available to support risks in the group as a whole, we have reservations concerning the proposed complete exclusion of minority interest from the common equity component of Tier 1 capital at consolidated level.

We would like to point out that the effects on capital of the proposed exclusion of minority interest on emerging market banks and international banks participating in emerging markets need detailed assessment. Banks may be allowed by emerging market regulators to participate only through minority positions. Alternatively, some emerging market regulators encourage international banks to expand their businesses via locally incorporated subsidiaries (sometimes not wholly-owned) rather than branches. Either way, the proposal might create a disincentive to investment in emerging markets which may have an adverse impact on diversification strategies.

Also, it is hard to see how complete exclusion of minority interest is either equitable or reasonable if the corresponding Risk Weighted Assets ("RWA") continue to be included.

Therefore, we suggest that minority interest be included in Core Tier 1 Capital but only to the extent that it is required to support the RWA of the subsidiary. Alternatively, the RWA for the subsidiary should be proportionately consolidated such that only the Group's share of RWA is included.

## 4. Transparency of disclosure

We are generally supportive of the proposals to improve transparency and market discipline by requiring banks to disclose additional information. However, we have strong reservations about one proposal, namely:

- that banks should disclose all limits and minima applying to their capital

We are of the view that the regulatory minimum capital level for individual banks is generally highly sensitive information which is, and should be, known only to the regulator and the relevant bank. This confidentiality is essential to ensure full and open dialogue between banks and regulators. Mandatory disclosure is likely to create volatility and instability in the banking industry as a whole because the information is open to misinterpretation and will be seen as the regulator's perceived assessment of the riskiness of the bank in question. This creates problems for banks but also gives rise to a 'moral hazard' type situation involving the regulator since investors and depositors will come to believe that they are, in effect, acting on the regulator's implied 'recommendations'.

## 5. Credit valuation adjustment

The proposal introduces a Credit Valuation Adjustment ("CVA") - capital erosion during the financial crisis occurred, in part, due to credit spread

changes rather than actual defaults. We are generally supportive of the proposal to factor CVA into the capital calculation.
However, the proposed hypothetical zero coupon bond method, while being complex and costly to implement, does not appear to capture the risks that it attempts to address.

Therefore, we recommend that BCBS should consider using simpler ways to adjust counterparty credit risk, such as an increase in alpha and add-ons. We urge BCBS to discuss the use of different approaches with industry participants before the proposals are finalized.

## 6. Leverage ratio

The document introduces a leverage ratio as a supplementary measure to the Basel II risk-based framework with a view to migrating to a Pillar I treatment based on appropriate review and calibration; it lists out detailed requirements for measurement of 'capital' and 'exposures'.

We support the concept of a leverage ratio as a back stop measure. However, the accounting measure of financial assets, derivatives, exposures and netting rules can vary across jurisdictions. HKFRS/IFRS can be different to other local generally accepted accounting practice ("GAAP").

Therefore, we suggest that the leverage ratio should be based on one set of prescribed calculation rules that apply across all jurisdictions and that the rules / measurements should be simple and uniform. Given the GAAP differences referred to above, reliance on accounting data will not create a level playing field rendering direct comparability across banks impossible.

A high leverage ratio should not be regarded as the only indicator of the balance sheet being over-stretched; other relevant factors should also be taken into account. To supplement the leverage ratio, we also recommend that the Asset to Deposit ratio should be a required disclosure. This assesses the ratio of customer assets to customer liabilities.

In short, our view is that capital should be based on regulatory Core Tier 1 capital. Assets should include derivative positions (as these generally represent the present value of future cash flows) and should include a standardized weighting for off balance sheet items such as committed facilities. Assets should also be adjusted for items already taken through capital, such as goodwill.

## 7. Cyclicality of the minimum requirements

We have concerns regarding the proposed use of a downturn Probability of Default ("PD"), based on the highest average PD estimates as a proxy. We consider the proposal to be too harsh, the fact that a dynamic approach will be adopted for loan provisioning and stress testing will be performed by banks means that this proposal might lead to duplication in providing capital. This excessive capital requirement will curtail growth in the real economy.

Notwithstanding the above, if BCBS still decides to use downturn PD it should recognize that different banks use different methods to calculate downturn PD and, in order to ensure comparability and a level playing field; it should provide clear and detailed guidance on how 'downturn' PD should be calculated.

## 8. Forward looking provisioning

It is said that the Basel committee strongly supports the initiative of the International Accounting Standards Board (the "IASB") to move to an expected loss ("EL") approach and the consultative document promotes an EL approach that captures actual losses more transparently and is also less pro-cyclical than the current 'incurred loss' approach.

However, proposals made by the IASB for provisioning based on EL are very different from those used under Basel II for capital purposes:

Firstly, the IASB's definition of expected loss (at least under the current proposals) is the loss expected over the entire life of the loan, whereas Basel II is only concerned with a one year time horizon.

Secondly, the IASB's expected loss is based on a point in time (being the date at which the accounts are drawn up). It is not clear how this relates to Basel II's 'through the cycle' concept of expected loss.

Therefore, we recommend that there should be as much consistency as possible between the IASB's proposals and the Basel proposals. This would not only make things easier from a system implementation / modelling / data retrieval perspective, but also make it easier both for banks and for readers of the accounts (financial analysts and public investors) to understand. Otherwise, banks would make two different disclosures in their accounts, one based on the 'IASB' concept and the other on the 'Basel II' concept, thus leading to confusion and misinterpretation.

## 9. Capital buffer

We are, in general, supportive of the objective of reducing the impact of pro-cyclicality on the capital requirements of banks. The paper recognizes that there is a range of options. Our primary concern is that each is additive in its impact, and could result in massively higher capital requirements to cover the same risk.

The proposed capital buffer has the characteristic of increasing the capital requirements of banks in good times so that the extra capital thus accumulated can be used in adverse economic conditions. There are, however, numerous practical and legal difficulties in implementing such buffers. For example, the very act of a bank dipping into the capital buffer would signal early warnings of failure to the market and could precipitate a crisis for that particular bank. That said, the paper does draw attention to the need for caution and the need to ensure that the risk profile of individual banks is factored into the need for a buffer and the size of the buffer.

It is also unclear how a buffer would be calculated for internationally active banks with a highly diversified geographical asset base. There is also the need for consensus between regulators as to the level at which this will be applied – at the subsidiary or at the group level, but not both.

Our recommendation is that the issue of pro-cyclicality be addressed separately. This should address credit concentration and diversification as well as the four solutions mapped out in the paper. One feature of the recent financial crisis was the concentration of risk in specific products and economies. In particular, when assessing systemic significance of banks and their size and international profiles the benefits as well as the risks of such diversified groups should be noted.

## 10. Addressing systemic risk and interconnectedness

There are no proposals being made at this stage on this issue. The paper does, however, refer to the possibility of capital add-ons or additional liquidity requirements. Such measures would be detrimental to the stability of the financial system as large and truly diversified international banking groups are better able to act as shock absorbers of losses. Secondly, where large international banks have caused instability to the broader banking system this has arisen from the business model and booking practices rather than from their scale itself. It is appropriate that these factors be considered alongside the impact of failure of large systemically important firms.

Furthermore, where a bank is well-capitalized and highly liquid, the probability of failure decreases, and the likely impact of failure is reduced. In these circumstances, it is unclear what benefit would accrue from making further add-ons to capital.

There are also dangers in adopting a "static" approach that is overly dependent upon the "large firm" perspective, and the business mix of banks. Alongside scale, there are other measures of riskiness such as those reflected in trading limits and the extent of customer rather than proprietary business undertaken.

We believe that the inter-connectedness issue raised in the paper is important, and that any future paper should consider the variety of business models employed in banking and the variety of regulatory approaches taken by regulators in their regulation of banks. The lack of an effective solo regulatory regime in many countries actively encourages inter-connectedness (the issuance of intra-group guarantees, and cash-"sweeping"). Whilst there are many benefits to a degree of connectedness with a banking group (in the form of diversification and loss absorption), this is a question of degree. There is, therefore, no "one size fits all" solution on this matter.

We believe that the focus of regulatory changes should be on prevention of failure rather than both the prevention and minimization of impact as this could result in the penalization of banks purely on the basis of size. Also, reducing or "taxing" large banks will reduce the capacity of the banking sector to support the global economy as banks will be discouraged from acquiring scale to ensure compliance with large exposure requirements.

## B) Consultative document – <u>International framework for liquidity risk measurement, standards and monitoring</u>

### 1. <u>Parameters & metrics</u>

In the computation of the "Liquidity coverage ratio" and "Net stable funding ratio", there are various parameters to be specified by national supervisors. In order to maintain a level playing field, we recommend that a set of standardized parameters (e.g. 7.5% or higher for retail deposit run-off) should be applicable to all banks under the same jurisdiction and should not be 'bank specific'. It is also important that international banks should not be disadvantaged by the application of the standards not being enforced on banks only active in local markets.

We would like to understand the derivation of the factors and obtain more clarity where parameters have not been set. As an example, "increases in market volatilities" would need to be well-defined to enable calculation of the liquidity impact by firms. We note that the detail required is onerous, e.g. establishing whether customers have "other established relationships". In some cases, further clarity of definition is required. For example, the ability to differentiate between "stable" and "less stable" deposits will need to be defined in more detail. We would support this being carried out by firms with rationale provided to the regulators.

In addition, we are of the view that the parameters and liquidity requirements are too stringent leading to a curtailment of both commercial and investment banking activities with a consequent impact on the real economy. We strongly recommend that the relevant parameters be carefully considered and reviewed once QIS data from the banking sector has been collected.

Finally, based on the relevant guidelines to be set by the national regulator, a bank should be allowed the flexibility to categorize its liabilities / deposits (on which the standardized run off percentages are applied) based on its own unique market position and historical experience regarding the stickiness of its liabilities.

## 2. 30 days' stress test

The proposed liquidity coverage ratio requires a bank to maintain an adequate level of unencumbered high quality assets that can be converted into cash to meet its liquidity needs for a 30-day time horizon under an acute liquidity stress scenario, which entails both institution specific and systemic shocks.

The 30-day combined institution specific and market-wide stress should be reconsidered. We consider the 30-day stress period to be too long for institution specific stress. As the experience of the last financial crisis shows, a bank either fails in the first few days or it survives longer term. Therefore, the modelling of an acute short term stress scenario which incorporates institution stress parameters should focus on the first week.

Consequently, we recommend that BCBS considers institution specific and market-wide stress separately. For institution specific stress, the desirable stress period should be one week. In case of market-wide stress, the stress period should be longer.

In addition, in order to maintain a level playing field, we recommend that the stress test requirements should be applied to all banks in the jurisdiction and should not just be targeted at internationally active banks.

Finally, the consultative document does not make it clear how any management actions or contingency funding measures would play a role in this stress test. In reality, these would be activated in advance of a stress or commensurately with an exogenous event precipitating a combined stress.

3. **Definition – Stock of high quality liquid asset**

The proposal states that eligible liquid assets include cash, central bank reserves, marketable securities (non central bank PSE, multilateral development banks and others) and government / central bank debts and probably corporate and covered bonds. The prescription seems to practically endorse cash and government and central bank debts to be the only true liquid assets given that assets not belonging to these categories are subject to severe haircuts.

For this proposal to work, all central banks / governments need to ensure there is sufficient supply in the market of paper they have issued. In jurisdictions where governments have sizeable fiscal deficits and large quantities of government securities are issued to finance such deficits, this may not be a challenge. However, in countries where the opposite is true, the issue of sufficiency of such government paper is a real issue. If not addressed properly, increased demand for a very limited supply of such paper would depress government bond yields and, therefore, longer term interest rates, which might have an adverse impact on the broader economy, leading to unintended consequences such as asset bubbles. A simple solution would be to accept a wider definition of liquid assets.

In addition, the narrow definition of liquid assets would lead to all banks holding the same asset type which would increase systemic risk. It is important for banks to hold a diversified portfolio of liquid assets. We have also seen, more than once, that some government paper does not hold up well in a stress situation.

Therefore, we strongly recommend that good quality corporate paper should be allowed to be included in liquid assets with appropriate hair-cuts which are not too severe and without all the other conditions which are extremely stringent. To do otherwise would lead to increased concentration risk, higher funding costs for corporate paper and, in certain jurisdictions, artificially low yields for government paper: all of these will have an adverse impact on the real economy.

Finally, clarification is needed from national regulators for the treatment of assets held for reserve requirements or other liquidity regimes. We would expect these to be accessible during a liquidity stress even where

this would take a firm below the typical reserve requirements. This will be imperative to avoid duplication of liquidity buffers.

## 4. Exclusion of bank paper

We are opposed to the proposal to exclude negotiable instruments issued by banks and investment and insurance firms from the definition of liquid assets on the following grounds:

Firstly, this makes it extremely unattractive for banks to hold paper issued by other banks and hence reduces the ability of banks to raise medium term funding. This could lead to a severe disruption of the liquidity transmission mechanism between banks.

Secondly, the criteria to determine high quality liquid assets take no account of the impact across national borders, e.g. a western market crisis does not make all Asian bank bonds illiquid.

Thirdly, requiring banks to invest only in central bank / government paper might not solve all the problems, given recent concerns about certain European government paper as an example. In view of heightened sovereign risk caused by high budget deficits in certain countries, we would highlight the perils of over-reliance on government paper and the importance of diversification.

Fourthly, by restricting what constitutes an eligible liquid asset, the proposals will lead to higher cost of liquidity which will eventually be passed on to customers, thus adversely impacting the real economy.

While we are generally supportive of the proposal to avoid "wrong way risk" when the banking sector is stressed, the total exclusion as proposed will lead to unintended consequences that will increase the concentration risk faced by banks and will also damage the real economy. Therefore, we recommend that paper issued by financial institutions should be included in the definition of liquid assets, with appropriate hair-cuts, provided it satisfies minimum credit-worthiness criteria to be determined by the BCBS.

## 5. Treatment of committed credit and liquidity facilities

The consultative document proposes that committed facilities extended to other banks would attract 100% drawdown (cash outflow), while no credit facility held from other banks is assumed to be able to be drawn (no cash inflow).

Assuming that none of the available committed lines can be drawn impacts the ability of banks to insulate themselves during certain stresses. There is little evidence that committed credit lines were generally not honoured during the last financial crisis.
This asymmetrical treatment also does not seem logical because it leads to the counterintuitive result that if a bank agrees a committed credit facility with another bank, the total amount of liquidity available in the system seems to decline, even though this causes no net outflow from the banking system either now or in the future.

In addition, we are of the view that banks may have committed facilities where one entity within the group provides committed facilities to other group entities. We strongly believe that such committed facilities should be counted as liquidity support in the receiving entity (i.e. able to be drawn down even under times of stress) as they are treated as negative liquidity by the providing entity, which ensures that the provider must hold sufficient liquidity to fully honour the commitment and liquidity at group level is not inflated. Moreover, such committed facilities have formal facilities agreement signed between the providing and receiving entities and are transacted on arms length basis, which ensures they are commercially robust.

## 6. Foreign currency deposits

Under the proposal, foreign currency deposits are considered to be 'less stable' than local currency deposits if there is reason to believe that such deposits are more volatile than domestic currency deposits. We believe that this decision should be left to the discretion of the local regulator since it is a function of local consumer behaviour and the local regulator is best placed to understand this.

It is our view that in sophisticated international financial centres like Hong Kong, there is no evidence that would lead to the conclusion that foreign currency deposits are less stable and that they should be treated on a par with local currency deposits.

## 7. Net stable funding ratio

We agree that this is a useful metric as it considers the structure of the balance sheet. The main issues relate to the factors applied as this does not seem to correlate with a banks' likely behaviour during a prolonged stress.

For example, the majority of bonds could be sold within a year even under a prolonged stress, whereas here the assumption is that funding is

required for 20%. It is unclear why 5% has been assumed for high quality liquid securities, although this may be to ensure adequate funding profiles for those liquid assets.

The 50% assumed for gold and equities is far too high. Gold would tend to be a flight-to-quality asset during a stress and could be sold easily. Similarly the majority of equities could be sold within a year. 5% for both of these categories would be more appropriate to ensure adequate funding profile.

The parameters here do not consider likelihood of rollover, e.g. 50% assumed for all non-financial corporate loans and 85% for loans to retail clients. This does not consider the varying customers' behaviours depending on the underlying business models, the granularity of the customer base or the ability of firms to run down their asset books under prolonged stress scenarios. These ratios should be determined by firms based on their core analysis and consideration of potential to change the business model of time.

The treatment of off balance sheet items is vague and the link to a 'reserve' of stable funding for liquid assets seems spurious. The factor is not determined here, so would depend on the assessment by national regulators. The most significant case here is the treatment of derivative MTM which will very largely net but provide significant grossing up on an IFRS balance sheet. It would be more appropriate to apply a consistent weighting to both asset and liability derivative MTM or apply the weighting to only the net exposure.

The treatment of undrawn facilities is largely left to national supervisors. This is likely to lead to uneven application. Furthermore, no account seems to be taken of the maturity of the facilities. Therefore, concrete proposals from BCBS on these areas are desirable.

## 8. Application of standards and monitoring tools

The proposal requires that the standards and monitoring tools be applied to all internationally active banks on a consolidated basis.

For large international banks, clarity is needed on how the standards and monitoring tools would be applied for overseas branches and subsidiaries. In addition, home regulator's reliance on overseas regulators' work after assessing their adequacy of supervision, and a limited scope in application (for overseas branches and subsidiaries) are positive factors in avoiding any unnecessary regulatory duplication, which is critical to minimizing the regulatory burden.

Potentially, the number of different regulatory reports and returns required (all pertaining to monitor and manage under the same framework as proposed by the Paper) would be a heavy burden if full scope application is required by home regulator for overseas branches and subsidiaries and also by the relevant overseas' regulators. This excessive burden, which actually does not in any way enhance the stability of the banking sector, should be avoided.

Also, as liquidity is increasingly not fungible across borders, we believe monitoring on a 'consolidated' basis should not be a point of focus: instead, regulators should look at how individual banks manage and control liquidity risk, be it on an individual legal entity basis or, where there is appropriate fungibility, on a geographical basis.

**9. Public disclosure**

The proposals require that all information on the metrics, particularly on the standards, should be publicly disclosed.

While we generally support greater transparency in disclosure, we are of the view that the mandatory disclosure of certain information, for example the "liquidity coverage ratio" and the "net stable funding ratio" could be counter-productive. Many of the assumptions and calculation rules used to arrive at these metrics will vary from bank to bank and from one regulator to the next. Readers of the information will not be aware of these differences and, even if they were, would be unlikely to understand the impact. The result would be that any metrics that were published would be used as simplistic stand-alone indicators of the general robustness of different banks thus leading, in many cases, to inappropriate and misleading conclusions.

In view of this, we do not support the public disclosure of the "liquidity coverage ratio" and the "net stable funding ratio".

**Miscellaneous**

**A1) Strengthening the resilience of the banking sector**

**1. Unrealized gains and losses on debt instruments and equities**

It is noted in the proposal that the treatment of unrealized gains will be reviewed by the BCBS during 2010.

Will the future guidance regarding treatment of unrealized gains and losses be consistent with the IFRS9?

**2. Investment in own shares (treasury stock)**

We would like to clarify with the BCBS on the following:

a. What is the definition of 'index securities', e.g. does it include Index ETFs that mimic a return of an index? (this can be done through derivatives and may not represent actual equity holdings)

b. How should the deduction amount to be determined, especially in the case of 'index securities' that do not have any actual equity holdings?

## A2) International framework for liquidity risk measurement, standards and monitoring

**3. Characteristics of high quality liquid assets**

Paragraph 29 states that the "high quality liquid assets" should possess low credit and market risk.

Clear definitions of low duration, low volatility and low inflation risk are required. From liquidity perspective, certain assets with longer maturity (e.g. 5-year US Treasury) also possess good liquidity. It is suggested including such assets in the calculation of "high quality liquid assets" and applying appropriate haircuts if deem necessary.

**4. Cash inflows – reverse repos and secured lending**

There is no clear definition of "liquid assets' and "illiquid assets" in reverse repo transactions. Since the treatment for derivation of cash flow of those assets is different, it is suggested to provide clear guidelines on the definition.

**5. Monitoring tools – concentration of funding**

Paragraphs 107 to 109 define "significant" counterparty, product / instrument and currency as those positions that account in aggregate for more than 1% of the bank's total liabilities.

We would like to clarify with the BCBS on the following:

a. Definition of instrument / product is unclear.

THE
HONG KONG
ASSOCIATION
OF
BANKS
香港銀行公會

b. Definition of group of similar instruments / products is unclear.

We also recommend that 10% be the threshold of significant currency which is to be in line with the current HKMA definition.
In addition, under the proposal, banks are expected to be able to meet their liquidity needs in each currency and maintain high quality liquid assets consistent with the distribution of their liquidity needs by currency.

While generally supportive of meeting the requirements by 'significant currency', we recommend to factor in the fungibility of liquidity between G7 currencies and HKD (due to the peg to USD).

If you have any questions or require any clarification, please do not hesitate to contact us.

Yours faithfully

Rita Liu
Secretary

c.c. Ms. Karen Kemp, Executive Director (Banking Policy), Hong Kong Monetary Authority