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

16 March 2016

By email: baselcommittee@bis.org

Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz 2
CH-4002 Basel
Switzerland

Dear Sirs

BCBS Consultation on Identification and Measurement of Step-in Risk

We refer to the Consultation on Identification and Measurement of Step-in Risk issued by the Basel Committee on Banking Supervision (BCBS) in December 2015.

On behalf of our members, we set out in the annex our detailed comments on the proposals in the consultative document.

We hope you find our comments useful. For any questions, please do not hesitate to contact Ms Emily Ngan of the Secretariat at (852) 2526 6080.

Yours faithfully

Doris Ma
Secretary

Enc.

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

Annex

HKAB Comments on BCBS Consultative Document on Identification and Measurement of Step-in Risk

Part A: General comments

Member banks generally agree with the Committee's intention to address and recognize step-in risk. However, the following concerns are raised by some member banks:-

- *Risk-sensitivity of the framework*

  One member bank commented that step-in risk should be dealt with in a manner which is appropriate for its specific nature and would involve significant amount of judgment and idiosyncratic assessment. The member bank considered that this conceptual framework is relatively mechanical and not sufficiently risk-sensitive to properly assess the capital requirement for each bank in terms of its exposure to step-in risk.

  Given the proprietary and sensitive information required in making step-in risk assessment, the member bank suggested the Committee to consider an approach whereby step-in risk is captured under its internal risk assessment process framework under the engagement with their local prudential regulatory supervisors so as to better reflect the jurisdictional diversity of step-in risk exposure.

- *Definition of step-in risk and differentiation from reputational risk under Pillar 2 regime*

  One member bank suggest to define step-in risk as the risk that banks suffer potential loss from their exceptional financial support or absorption of those assets of connected entities beyond their contractual obligation.

  Since the document is to address step-in risk rather than reputational risk, the member bank also suggest to avoid terms such as "reputational step-in risk" (paragraph 14) and "reputational risk of step-in" (paragraph 69) that could lead to the ambiguity of risk type categorization, and consequently the identification criteria and measurement approach to be applied could mismatch with the exact risk type to be addressed. In addition, to avoid double-count of risk losses, any potential loss of reputational risk that has been captured under existing Pillar 2 regime should be excluded from step-in risk measurement.

<u>Part B: Comments on the specific questions listed in the consultative document</u>

Question no.	Question	Comments
Q1.	What are commenters' views on the four overarching principles? Are there any others that should be included?	One member bank suggested adding one more principle to the framework - to protect the financial stability of banking system from any severe losses of the potential step-in risk. Amongst the overarching principles stated in the paper, member banks identified some discrepancies and looked for further guidance from the Committee to deal with such discrepancies:- • Principle 2 promotes simplicity and consistency of approach whereas Principle 4 states that specific feature should also be considered as idiosyncratic, one-off assessment based on supervisors' judgment. • The aim of replicating the ex-ante situation after the step-in event as mentioned in Principle 1 might not be sufficiently risk-sensitive as stated in Principle 3.
Q2.	What are commenters' views on the proposed indicators for step-in risk? Are there any additional ones that the Committee should consider?	One member bank commented that the proposed indicators in "3.1.2. Table of primary indicators" from page 14 to 16 may result in most of related entities falling in the application scope of this step-in risk framework and thus exceeding the scope of "experience from the financial crisis" as mentioned in Part 1 of the consultative document. Other member bank also highlighted the need for the Committee to embed primary indicators into the broader framework of regulatory consolidation.

Question no.	Question	Comments
Q3.	What are commenters' views on the proposed secondary indicators for step-in risk? Are there any additional ones that the Committee should consider? Should any of them be considered as primary indicators?	One member bank considered that the proposed secondary indicators would be difficult to implement and suggested the Committee to provide full guidance on eligible step-in risk mitigating actions along with the primary indicators.
Q4.	What are commenters' views on the different potential step-in risk assessment approaches? Are there any other approaches that the Committee should consider to account for step-in risks?	Member banks raised the following concerns over the consolidation approaches:- - If the risk calculation requirement under consolidation approach would be similar to the existing Pillar 1 calculation, the burden to collect and validate comprehensive risk information, including the credit, market and operational risk-weighted assets held by the sponsor would outweigh the overarching principles of simplicity (Principle 2) and operational readiness (Principle 4) - Full consolidation approach does not reflect the varying likelihood of step-in under different circumstances. Member banks further suggested inclusion of the following factors in step-in risk assessment:- - actual historical loss rate of step-in support during the financial crisis - the correlation of loss rate with the risk asset size - risk asset type of those unconsolidated entities that were financed - past behavior and risk appetite towards absorbing reputational damages - probability of step-in

Question no.	Question	Comments
Q5.	What are commenters' views on the proposed mapping between the primary indicators and the potential approaches?	Some member banks are of the view that the conversion approach is the most consistent with the contingent/exceptional nature of banks' step-in support in distress. Conversion approach based on the total assets of an unconsolidated entity is also more practicable than full consolidation approach and proportionate consolidation approach. Member banks also commented that the adoption of full consolidation approach to both full sponsor (category 1) and sponsor (category 4 and 5) did not adequately reflect the different level of risk involved in each scenario.
Q6.	What are commenters' views on proportionate consolidation for joint-ventures?	Member banks agreed on a pro-rata basis in measuring the step-in risk of joint-ventures but would suggest the Committee to consider the following approach other than the proportionate consolidation:- - applying a proportionate conversion approach to joint-ventures in view of the contingent and exceptional nature of the step-in support provided by the sponsoring banks just in distress; - taking into account the specific nature of individual joint ventures and the step-in behavior of individual institutions.