

HKMA Statutory Consultation on MR-1 and MR-2

October 2023



Introduction

The Hong Kong Monetary Authority (“HKMA”) issued a letter on 3 October 2023 to consult the banking industry on updates to the new Supervisory Policy Manual (“SPM”) Modules MR-1 “Market Risk Capital Charge”¹ and MR-2 “CVA Risk Capital Charge”² as part of their overall Basel III reform package.

In drafting these consultative SPMs and rules, the HKMA has taken into consideration the relevant industry feedback and comments. In addition to this release, several other rules related to capital, exposure limits, disclosures, and liquidity will be separately released to the industry or relevant associations.

Implementation Deadlines

The HKMA plans to publish the rules and guidance in the Gazette and will table the rules in the Legislative Council (“LegCo”) within 2023. The implementation will be no earlier than 1 July 2024 (in relation to credit risk, operational risk and the output floor) and no earlier than 1 January 2025 (in relation to market risk and credit valuation adjustment (“CVA”) risk).

Key updates of the statutory consultation

KPMG has summarized the key market risk updates from the statutory consultation into 5 main areas: structural foreign exchange (“FX”), boundaries between the trading and banking books, internal model approach, and adjusted CVA requirements.

1. Structural FX

Provides an updated illustrative example on how to determine the maximum amount to be excluded under the structural FX exemption.

2. Boundaries between Trading and Banking Books

- Specifies that instruments that are measured at fair value with value changes recognised in the profit and loss account are generally perceived as being held for profit from short-term price movements.
- Provides the HKMA’s expectation on the discharging process for the capital surcharge resulting from switching of books.
- Clarifies the requirement on the setup of General Interest Rate Risk (“GIRR”) Internal Risk Transfer (“IRT”) desk that GIRR IRTs may be allocated to a trading desk that need not have traders or trading accounts assigned to it.
- Clarifies that the requirements for the trading desk only applies to the internal model approach.

¹MR-1 “Market Risk Capital Charge” https://www.hkma.gov.hk/media/gb_chi/regulatory-resources/consultatons/Annex_3_SPM_MR-1_Market_Risk_v1.pdf

²MR-2 “CVA Risk Capital Charge” https://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/SPM_MR-2_CVA_Risk_v1.pdf



3. Standardised (Market Risk) Approach

- Allows a pair of back-to-back transactions to be considered as one instrument in the Sensitivities-Based Method (“SBM”) given that the net sensitivity of such a pair of back-to-back transactions is always zero from the market risk perspective.
- Allows the use of internal ratings for issuers without an External Credit Assessment Institutions (“ECAI”) issuer rating under SBM and under the Standardized Approach for Default Risk Charge (“SA-DRC”) for Internal Ratings Based (“IRB”) Authorised Institutions (“AIs”) (subject to approval by the HKMA).
- Aligns the list of exposures that would be allocated to 0% risk weight for the purpose of the SA-DRC with the Basel standard by changing “sovereign foreign public sector entities” to “public sector entities”.
- Incorporates Basel Committee on Banking Supervision’s (“BCBS”) frequently asked questions (“FAQ”) on the within-bucket correlation for Credit Spread Risk (“CSR”) and commodity vega risk factors with a smaller number of dimensions for the vega risk factors than the delta risk factors
- Incorporates BCBS FAQ on commodity delta risk factors calculated for futures and forward contracts.
- Incorporates BCBS FAQ that GIRR vega risk factors in relation to inflation and cross-currency bases should be considered only along the single dimension of the maturity of the option.
- Clarifies that the commodity curvature weight is a relative shift of all the tenors for each curve based on the delta risk weight of the commodity.



4. Internal Model Approach

- Provide examples of key components of core documentation, such as scope of application, methodology, assumptions, limitations, data sources, instructions for model users and procedures of model validation.



5. Adjusted CVA Requirements under Basic and Standardised Approaches

- Provides guidance where there is more than one ECAI issuer rating or when there is no ECAI issuer rating to assign a risk exposure to a credit quality. For the latter case where there is no external rating, AIs that use the IRB approach to calculate their credit risk capital charge may, subject to HKMA approval, map the internal rating to a corresponding external rating. Otherwise, the risk weights for unrated counterparties should be applied.

Basel III Implementation Timelines Across Key Markets in APAC

Market	Regulatory Timelines			
	FRTB	Credit risk	CVA	Operational risk
Hong Kong SAR	01-Jul-24* 01-Jan-25	01-Jul-24	01-Jul-24* 01-Jan-25	01-Jul-2024
China	01-Jan-24	01-Jan-24	01-Jan-24	01-Jan-24
Singapore	01-Jul-24* 01-Jan-25	01-Jul-24	01-Jul-24* 01-Jan-25	01-Jul-24
Indonesia	01-Jan-24	01-Jan-23	01-Jan-24	01-Jan-23
Korea	01-Jan-23	01-Sep-20	01-Jan-23	01-Jan-23
Australia	01-Jan-26	2026	2026	01-Jan-23
Japan	31-Mar-24^ 31-Mar-25#	31-Mar-24^ 31-Mar-25#	31-Mar-24^ 31-Mar-25#	31-Mar-24^ 31-Mar-25#

Notes:

* Commencement date for reporting only, with the regulatory requirements taking effect on the later date

^ Commencement date for internationally active financial institutions and non-internationally active financial institutions that use internal model-based approaches for measuring risks

Commencement date for non-internationally active financial institutions that do not use internal model-based approaches for measuring risks

How KPMG can help

KPMG is a market leader in interpreting FRTB rules. We offer a suite of solutions to help you navigate FRTB implementation, including the following key areas:



Gap Analysis

- Decomposing the rules and managing rule ownership assignment
- End-to-end rule traceability from rules to your policies and procedures, business requirements, functional requirements and UAT
- Drafting detailed action / remediation plans



Implementation Support

- MR-1 and / or outstanding FRTB activities to meet deadlines
- Updating policies and procedures
- Upgrading data, systems and (internal and external) reporting
- Applications to use internal model approaches (where these are still available)
- Final Independent compliance review of FRTB implementation



Post Implementation Optimisation

- Planning for and managing any increase in capital requirements
- Optimising risk management practice, risk appetite statement and limit setting
- Asset portfolio adjustments and balance sheet optimisation in response to changes in risk weightings

Contact us



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