

# Recalibrated Collateral and Guarantee Requirements: Enhanced CR-G-7



September 2024

In June 2024, the HKMA published a consultation<sup>1</sup> on **proposed revisions to the Supervisory Policy Manual (SPM) module CR-G-7 “Collateral and Guarantees”**.

This update (subject to any post consultation changes) will supersede the previous CR-G-7 SPM (2001) and provide guidelines on **the use of collateral and guarantees for credit risk management purposes**. While the guidance does not seek to replace any specific Banking Capital Rules, this update attempts to strengthen Authorised Institutions (AI) management over collateral, guarantees and Credit Risk Mitigation (“CRM”).

What this means in practice is a far greater discipline will be needed in managing CRM and the resulting consequences for **Loan-to-value (LTV) and Loss Given Default (LGD) values within Risk Weighted Assets (RWA)** calculations. LGD measurement will become more transparent, sensitive to change and subject to greater scrutiny on validation. The new CR-G-7 will bring greater focus on RWA utilization and the inherent economic return on exposures that are subject to CRM. As such there is a direct and heightened interaction with the HKMA’s new Basel III requirements.

## Key changes in the CR-G-7 SPM:

Area	Key requirements that have been updated:
<p><b>Introduction, Scope, and Risks with CRM</b></p> <p>§ 1.1-1.3</p>	<ul style="list-style-type: none"> <li>• <b>Enhanced definitions</b> of CRM, e.g., <b>credit protection providers</b> include various types of credit insurance, and clearer terminology for financial collateral, physical collateral and guarantees;</li> <li>• <b>New scope of application</b> includes CRM for Counterparty Credit Risk (CCR) and credit risk from share margin financing, as well as derivative contracts, albeit these also remain subject to specific SPMs<sup>2</sup>;</li> <li>• <b>CRM risks</b> are broadened to account for the <b>inability to enforce</b> rights to collateral, and the amount eventually recovered may be <b>less than originally</b> estimated, necessitating stronger controls.</li> </ul>
<p><b>CRM Management Policies, Procedures and Limits</b></p> <p>§ 2.1-2.4</p>	<ul style="list-style-type: none"> <li>• Greater expectations on the Board of Directors and management’s oversight over CRM policy, procedures, systems, and controls, and <b>more prescriptive expectations</b> on:             <ul style="list-style-type: none"> <li>- <b>Clear delegation of authorities and responsibilities</b> or approving the acceptance, monitoring and enforcement/release of CRM;</li> <li>- <b>Clear definitions of acceptable forms of CRM</b>, taking into account laws or regulations (e.g. <b>the Banking (Exposure Limits) Rules (Cap. 155S) (BELR)</b>);</li> <li>- <b>Types of risk</b> (i.e. residual risks, including legal, operational, liquidity and market risks) arising from the use of CRM;</li> <li>- <b>Collection of data and compilation of management information</b> on CRM for different purposes;</li> <li>- <b>More prescriptive LTV ratios, margin levels and haircuts</b>, including precision in exposure calculation and costs of holding/enforcing collateral, and buffer for stressed situations, currency mismatch and liquidity risk;</li> </ul> </li> </ul>

<sup>1</sup> HKMA: [Revised\\_SPM\\_Module\\_CR-G-7\\_V.2\\_\(Consultation\).pdf \(hkma.gov.hk\)](#) (NB: the consultation has now closed)

<sup>2</sup> HKMA CR-S-4: [CR-S-4.pdf \(hkma.gov.hk\)](#) ; <sup>2</sup> HKMA CR-G-13: [CR-G-13 Counterparty Credit Risk Management \(hkma.gov.hk\)](#)

<sup>2</sup> HKMA CR-G-14: [Non-centrally Cleared OTC Derivatives Transactions – Margin and Other Risk Mitigation Standards \(hkma.gov.hk\)](#) ; <sup>2</sup> HKMA CR-G-12: [CR-G-12.pdf \(hkma.gov.hk\)](#)

# Key changes in the CR-G-7 SPM:

Area	SPM's broadened scope and greater expectations
<p><b>CRM Management Policies, Procedures and Limits</b></p> <p>§ 2.1-2.4</p>	<ul style="list-style-type: none"> <li>Enhanced <b>systems of controls</b> requirements;</li> <li>Enhancements to <b>concentration limits</b> on CRM, including <b>geography of location</b>, issuers of financial instruments taken as collateral or guarantee in <b>same group or industry</b> as well as <b>enhanced requirements on risk appetite for concentration risk</b>;</li> <li>New requirements on <b>regular reviews</b> when risk appetite or strategies change as well as the <b>role of internal audit and compliance teams</b>.</li> </ul>
<p><b>Eligibility of CRM</b></p> <p>§ 3.1-3.3</p>	<ul style="list-style-type: none"> <li>More <b>prescriptive rules on eligibility</b> covering SPVs, insurance, trade receivables;</li> <li>More expectations on evaluation, including explicit recognition of correlation risk within borrower's <b>groups</b> or providers of CRM, with exemption for SPVs that have little to no independent capacity to repay the exposure;</li> <li>CRM that do not meet eligibility criteria are now explicitly <b>excluded from the credit assessment</b>, being treated as "<b>comfort value only</b>";</li> <li><b>Collateral and guarantee requirements enhanced</b>, to include requirements on insurance policies used as collateral, collateral realization time periods, credit protection providers that are financial institutions need to be regulated by a competent authority, assessment of financial strength of the credit protection provider must be <b>under the same rigorous credit risk assessment process as applied to a borrower</b>;</li> <li>Enhanced documentation so that the <b>extent of the credit protection provided by the guarantee is clearly defined without ambiguity</b>.</li> </ul>
<p><b>Validity of CRM</b></p> <p>§ 4.1-4.3</p>	<ul style="list-style-type: none"> <li><b>Enforceability</b> requirements are expanded, including specifying a need for <b>administrative completeness</b> when using CRM, i.e., practical enforceability of any <b>cross-border CRM</b>, like <b>SAFE<sup>3</sup> approval</b>;</li> <li>New requirements on collateral to take reasonable steps to ensure collateral held by any <b>third party custodians</b> is held in a <b>bankruptcy remote</b> and not subject to set-off priorities;</li> <li>Explicit requirements to comply with relevant laws and regulations of Hong Kong and <b>other jurisdictions</b>. e.g., concentration limits as part of Hong Kong's <b>BELR requirements</b>.</li> </ul>
<p><b>Valuation of Collateral</b></p> <p>§ 5.1-5.5</p>	<ul style="list-style-type: none"> <li><b>Valuation criteria</b> are <b>more comprehensive and prescriptive</b>, including: <ul style="list-style-type: none"> <li><b>Types of valuation</b>: need for clear standards on acceptable types of valuation;</li> <li><b>Basis of valuation</b>: assessing the current value's sustainability over the life of the credit exposure, taking into account all relevant factors including climate risk, liquidity, obsolescence and deterioration, not assuming expected future price appreciation and not higher than observable market values;</li> <li><b>Appraisers competence</b>: new requirements on assessing appraisers including governance, roles of risk management, assessment criteria and validation;</li> <li><b>Frequency of revaluation</b>: establishing revaluation triggers if there are reasons to believe the value has fallen significantly or there is higher market volatility;</li> <li><b>Independence of valuation</b>: Avoiding any conflicts arising from appraiser compensation.</li> </ul> </li> </ul>
<p><b>Risks of Failed or Reduced Credit Protection</b></p> <p>§ 6.1-6.6</p>	<ul style="list-style-type: none"> <li>Enhanced requirements on procedures and processes to control risks of failed or reduced credit protection, i.e., arising from the impact of <b>market turmoil, climate risk, collateral obsolescence, credit protection providers credit quality deterioration</b>;</li> <li>More requirements on <b>safe custody and access controls</b> as well as regular reconciliation;</li> <li>More explicit requirements for <b>insuring collateral against damage or loss</b>, such as ensuring the insurance is valid until collateral is released by the AI;</li> <li><b>Enhanced evaluation of CRM quality after acceptance</b>, including regular and prompt review, new requirements for <b>movable physical collateral</b> and <b>off-plan property</b>, regular review of both <b>financial collateral</b> and guarantees, and protective measures to identify any deterioration in the CRM effectiveness over the exposure;</li> <li>New requirements on collateral maintenance related <b>systems and controls to monitor collateral</b> requests and market values;</li> <li><b>Enhanced stress-testing requirements</b> to assess CRM effectiveness when markets are stressed.</li> </ul>

3 SAFE: State Administration of Foreign Exchange

# Key changes in the CR-G-7 SPM:

Area	SPM's broadened scope and greater expectations
<b>Release and Realisation of CRM</b> § 7.1-7.2	<ul style="list-style-type: none"> <li>Enhanced requirements on the <b>release of CRM</b> including legal documentation, care and due diligence when assessing any new substituted CRM, and adjustments to limits;</li> <li>Amended requirements on realization and assets acquired by an AI must align with <b>BELR requirements on the max holding period</b>.</li> </ul>
<b>Management information system</b> § 8.1-8.2	<ul style="list-style-type: none"> <li>New requirements on data collection <b>processes and systems</b> to collect CRM data for MIS reporting and governance oversight;</li> <li><b>MIS has been expanded to include CRM composition and concentrations</b>, revaluation due dates, and recovery rates;</li> <li>Specific HKMA requirements include: frequency and purpose of management reports, valuations, concentration, haircuts and follow up actions.</li> </ul>

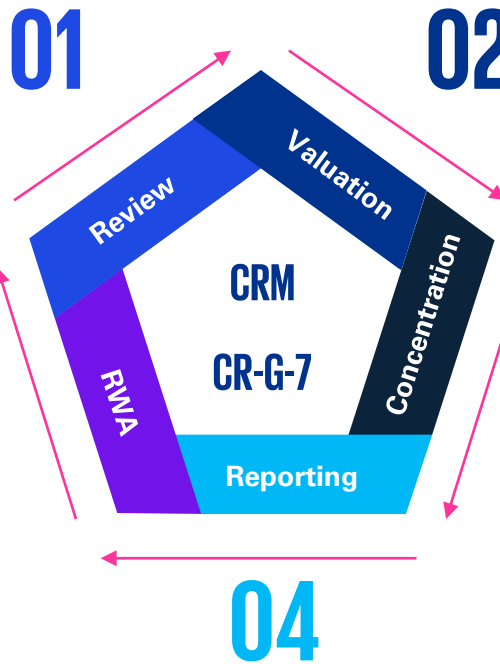
## How KPMG can help

### CRM Framework

- Conduct detailed gap analysis and provide a report to highlight CRM framework gaps
- Support you to implement enhancements to CRM policies, procedures, framework to meet the uplifted SPM requirements on CR-G-7

### RWA Impacts

- Review and recommend to enhance collateral valuation and allocation methodology, and to undertake a quantitative impact assessment on RWA to measure the full impacts of the revised SPM implementation.



### 02 Uplifting CRM Valuations & LTV

- Valuation and CRM processes, including methodology to allow buffer for stressed market, climate risk (such as flood damage), liquidity risk and volatility of exchange rate
- LTV methodology alignment with new requirements, e.g. including the undrawn portion of any credit facility.
- LTV methodology, e.g., inclusion of costs of collection or repossession, carrying costs, and costs for disposing for real estate.

### 03 Limits and Correlations

- Undertake a quantitative assessment of CRM concentration and correlations looking at your collateral, types of guarantee, geographical location for immovable property, industry sectors (including closely related sectors) and CRM protection providers from the same entity (or entities in the same group).
- Recommendation and implementation support to meet new requirements as per the CR-G-7

### 04 Systems and Data

- Review existing systems, data and management reporting.
- Recommend business requirements and suggest automation tools to improve MIS reporting efficiency.
- Implementation support and UAT.

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