Subcommittee on
Banking (Capital) (Amendment) Rules 2012,
Banking (Specification of Multilateral Development Bank)
(Amendment) Notice 2012 and
Banking (Amendment) Ordinance 2012 (Commencement) Notice 2012

Administration's Response to Issues
arising from the meeting held on 16 November 2012

At the meeting of the Subcommittee held on 16 November 2012, Members asked the Administration to elaborate on the implementation of Basel III in other jurisdictions, including –

(a) jurisdictions which have issued final rules for implementation of Basel III from 1 January 2013 onwards; and

(b) jurisdictions in an advanced stage of preparation, including the situations and progress in the European Union ("EU") and the United States ("US").

Administration's Response

2. Addressing the lessons learned from the recent global financial crisis, Basel III is aimed to bring about a better capitalised and more resilient banking system, which is less susceptible to generating adverse spillover effects to the real economy in times of stress. Recognising the importance of Basel III in strengthening the financial system, a number of jurisdictions (not only members of the Financial Stability Board ("FSB"), Basel Committee on Banking Supervision ("Basel Committee"), but also other non-member jurisdictions) are working towards implementation of the Basel III enhanced capital standards. The Basel Committee has determined that 1 January 2013 should be the starting date for the first phase of implementation of Basel III.

3. In a letter sent by the Chair of the **FSB** to the G20 Finance Ministers and Central Bank Governors of 31 October 2012, the FSB Chair noted that: "**It is crucial that all jurisdictions redouble their efforts to pass legislation that is consistent with the Basel III framework by the agreed deadline**".

4. In a communiqué issued by the **G20** Finance Ministers and Central Bank Governors on 5 November 2012, the G20 Ministers and Governors reaffirmed that: "**We agree to take the measures needed to ensure full, timely and effective implementation of Basel II, 2.5 and III and its consistency with the internationally agreed standards**".

5. To this end, as we noted at the meeting held on 16 November 2012, Hong Kong remains committed to implementing Basel III following the timeline agreed internationally.

(a) Jurisdictions which have issued their final rules to take effect on 1 January 2013

6. As indicated in the Basel Committee's *Report to G20 Finance Ministers and Central Bank Governors on Basel III implementation* in October 2012, most of Hong Kong's peers in Asia have already issued final rules for Basel III implementation. These include **Australia, Mainland China, India, Japan and Singapore**. All of these jurisdictions, with the exception of Japan, will implement Basel III from 1 January 2013. In Japan's case, implementation will take effect from March 2013 to coincide with the fiscal year cycle for banks in Japan.

7. In the case of Australia, the phase-in period for the new minimum regulatory capital ratios set by the Basel Committee will be curtailed. Australian banks will be expected to meet the new minimum ratios in full from 1 January 2013, as opposed to the ratio levels being progressively phased-in from January 2013 to January 2015. Similarly, in Singapore, the new minimum ratios must be met in full from 1 January 2013 (i.e. without phase-in), and the Monetary Authority of Singapore will require Singaporean banks to meet higher regulatory capital ratios than the minimum Basel III ratios (with such higher ratios being phased-in from 1 January 2014 to 1 January 2015)[1].

8. Elsewhere, Switzerland has issued its final rules for Basel III implementation to take effect from 1 January 2013. In the case of its two largest systemically important banks, higher minimum standards will be imposed over a transition period until 2018.

[1] Singaporean banks will ultimately be required to meet a Common Equity Tier 1 capital ratio of 6.5%, a Tier 1 capital ratio of 8% and a total capital ratio of 10%, as opposed to the Basel III minima of 4.5%, 6% and 8% respectively.

(b) Jurisdictions in advanced stage of preparation and latest development[2]

9. Both the US and the EU are at an advanced stage of preparation for the implementation of Basel III. It now appears, however, that there will be some delay as they continue to work towards implementation.

United States

10. The US regulatory agencies issued three notices of proposed rulemaking covering Basel III in June 2012. The extended consultation period closed towards the end of October 2012, and the regulatory agencies are reported to be considering the submissions received.

11. On 9 November 2012, the US regulatory agencies announced that they did not expect the proposed rules to become effective on January 1 2013 but reiterated that they were working as expeditiously as possible to complete the rule-making process.

12. Recently the US was the subject of a "Basel III Regulatory Consistency Assessment" by the Basel Committee. The assessment was made in respect of the three notices of proposed rulemaking and a follow-up assessment will take place once the US agencies have published the final rules to implement Basel III.

13. Notwithstanding that Basel III is not yet in force, the US regulatory agencies have been subjecting major banks and bank holding companies to annual stress-tests, with a view to ensuring that they are sufficiently well capitalized to continue operations during times of economic or financial stress. For instance, the 19 largest banking holding companies covered in the Federal Reserve Board's stress-testing programme are required to demonstrate the ability to maintain a minimum tier 1 common capital ratio of 5% over a minimum of 9 quarters under both baseline and stress scenarios used in the programme. This effectively means these banking holding companies must hold capital levels comparable to Basel III standards. Thus, with regard to the largest institutions, significant recapitalization has been occurring post-crisis and in the run-up to Basel III implementation.

[2] In Asia, Korea appears to be in an advanced stage of preparation for implementation of Basel III, having issued a draft regulation on 27 September 2012. Elsewhere, Canada is well advanced, having (i) directed its banks in February 2011 to meet a 7% Common Equity Tier 1 standard by 1 January 2013; and (ii) issued a comprehensive capital regulation for public comment on 7 August 2012. Brazil has completed its consultation process on its draft regulations and is making final adjustments. South Africa issued, on 28 September 2012, draft amendments to legislation for final review and Saudi Arabia has issued final regulations to its banks.

EU

14. In the EU, the Capital Requirements Directive ("CRD") IV package, which will implement Basel III, is currently under discussion among the European Parliament, the European Commission and the EU Council of Ministers. The original intention was to finalise an agreed position by end June 2012 to enable adoption by the European Parliament plenary in early July 2012. However, the present intention appears to be to reach an agreement by the end of this year.

15. Although CRD IV has not yet been adopted in final form, some jurisdictions in the EU, notably the UK and Germany, have taken preparatory action. The German government has issued a draft CRD IV Implementation Act, whereas in the UK, the Financial Services Authority ("FSA") (which has previously stated that it will undertake all preparatory work possible in the absence of the finalised legislative text) has recently set out its proposed manner of implementation of transitional provisions in CRD IV.

16. The Basel Committee has conducted a Basel III Regulatory Consistency Assessment of the EU based on a CRD IV compromise proposal of May 2012 and a follow-up assessment will take place once the EU authorities publish the final rules text.

17. In terms of bank recapitalization to pave the way for transition to the CRD IV framework, the European Banking Authority ("EBA") has been conducting a "capital exercise" (a form of stress-testing) on 71 of Europe's largest banks. In December 2011, a temporary target ratio of 9% Core Tier 1 capital was set for those banks covered by the exercise to comply with from end June 2012. It now appears that this target will remain in force, and work is underway to map the 9% ratio which uses an EBA definition of capital to the CRD IV definition of capital.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
21 November 2012