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<u>TO</u>:

Mr. Frank Leung and Mr. Richard Chu
Banking Policy Department
Hong Kong Monetary Authority
Two International Finance Centre,
8 Finance Street, Central,
Hong Kong

Via E-mail

September 27, 2019

Re: Consultation paper on "Market risk" (CP 19.01)

Dear Mr. Leung and Mr. Chu,

The Global Foreign Exchange Division ("GFXD") of the Global Financial Markets Association ("GFMA") welcomes the opportunity to provide comments to the Hong Kong Monetary Authority ("HKMA") on its June 28, 2019 consultation on "Market risk" (CP 19.01) (the "Consultation Paper"). The Consultation Paper proposes amendments to the Banking (Capital) Rules ("BCR") to revise the market risk capital charges for locally incorporated Authorised Institutions ("AIs") to align with the final 2019 'Minimum capital requirements for market risk'[1] standards published by the Basel Committee on Banking Supervision ("BCBS").

The GFXD was formed in co-operation with the Association for Financial Markets in Europe (AFME), the Securities Industry and Financial Markets Association (SIFMA) and the Asia Securities Industry and Financial Markets Association (ASIFMA). Its members comprise 26 global foreign exchange (FX) market participants,[2] collectively representing a significant portion of the FX inter-

[1] Available at https://www.bis.org/bcbs/publ/d457.pdf (the "BCBS final standards".)

[2] Bank of America Merrill Lynch, Bank of New York Mellon, Barclays, BNP Paribas, Citigroup, Crédit Agricole, Credit Suisse, Deutsche Bank, Goldman Sachs, HSBC, JP Morgan, Lloyds Bank, Mizuho, Morgan Stanley, MUFG Bank, NatWest Markets, Nomura, Northern Trust, Royal Bank of Canada, Scotiabank, Société Générale, Standard Chartered Bank, State Street, UBS, Wells Fargo and Westpac.

dealer market. Both the GFXD and its members are committed to ensuring a robust, open and fair marketplace and welcome the opportunity for continued dialogue with global regulators.

The FX market is the world's largest financial market and the effective and efficient exchange of currencies underpins the world's entire financial system. The FX market is also the basis of the global payments system. The volume of transactions is therefore very high, and these transactions are often executed by market participants across geographical borders.

Many of the current legislative and regulatory reforms have had, and will continue to have, a significant impact upon the operation of the global FX market, and the GFXD wishes to emphasize the desire of its members for globally coordinated regulation, which we believe will be of benefit to both regulators and market participants alike.

We fully support the HKMA for taking initiatives to align capital charges for locally incorporated AIs with those outlined by the BCBS in its final standards. In this regard, we raise below several points which we ask that the HKMA take into account when finalizing the amendments to the BCR.

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13.7 Foreign Exchange Risk

The Consultation Paper allows AIs, at their discretion, to apply risk weights of 1.3% for USD/HKD (paragraph 181) and 15%/√2 for selected currency pairs, including their first order crosses, as listed in the BCBS final standards[3] (paragraph 182).

The intention seems clear, however under the current drafting it is unclear what risk weight (presumably, 15%) would apply to USD/HKD, or the listed currency pairs and first order crosses should the AI not exercise the discretion provided for under paragraphs 181 or 182, since paragraph 180 states that "*A risk weight of 15% applies to risk sensitivities of all the currency pairs* ***except*** *USD/HKD and the currency pairs in the footnote 39 below.*"

We also believe USD/HKD should be included with the pairs in the footnote, to ensure the same treatment as the other listed pairs (except for the additional unique discretion for USD/HKD allowing a 1.3% risk weight).

[3] BCBS final standards paragraph 21.88.

Accordingly, we suggest the following drafting edits to the text in Section 13.7:

13.7 ***Foreign Exchange Risk***

179 A foreign exchange risk bucket is set for each exchange rate between HKD and the currency in which an instrument is denominated.

180 A risk weight of 15% applies to risk sensitivities of all the currency pairs except, to the extent the discretion referenced in paragraph 181 or 182 below has been exercised, ~~USD/HKD and~~ the currency pairs in ~~the~~ footnote 39 below.

181 The risk weight of USD/HKD may, at the discretion of the AI, be set at 1.3% on the rationale that this risk weight captures the fluctuation of USD/HKD within the Convertibility Undertaking range (i.e. 7.75 to 7.85) under the Linked Exchange Rate System. AIs using the FX base currency approach as set out in paragraph 113 with USD as the selected base currency, will not be allowed to make use of this preferential risk weight.

182 The risk weight of the currency pairs ~~mentioned~~ in footnote 39 (including their first-order crosses) may, at the discretion of the AI, be set at 15% divided by the square root of 2.

183 A uniform correlation parameter γ_{bc} that applies to the aggregation of delta foreign exchange risk positions is set at 60%.

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[39] Selected currency pairs are: USD/AUD, USD/BRL, USD/CAD, USD/CHF, USD/CNY, USD/EUR, USD/GBP, USD/INR, USD/JPY, USD/KRW, USD/MXN, USD/NOK, USD/NZD, USD/RUB, USD/SEK, USD/SGD, USD/TRY, USD/ZAR, and USD/HKD (including their first-order cross-currency pairs between each other)~~, and their first-order cross-currency pairs with USD/HKD~~. For example, EUR/HKD is not among the selected currency pairs, but is a first-order cross of USD/EUR and USD/HKD. The selected currency pairs could be subject to update. AIs should build their market risk capital calculation systems with sufficient flexibility to account for this potential periodic update.

International Harmonization

In finalizing the Consultation Paper proposals, we also ask that the HKMA consider international developments in this area and monitor the adoption status in other key jurisdictions.

Given the international nature of the FX market, it is particularly important for us that international standards such as these to be applied consistently across jurisdictions, enabling banks to operate on a global level-playing field. Furthermore, it is important for globally active banks that international standards are implemented in a coordinated way, following a consistent timeline across jurisdictions, and with a reasonable implementation period for banks once the legislative process is finalized.

We are concerned by the possibility that the HKMA implementation process will preempt the implementation process in other key jurisdictions such as the EU and the US. In the EU, it is uncertain if the BCBS timeline of January 2022 will be adhered to and in the US there are indicators suggesting a draft implementation proposal will be published only in late 2019 or early 2020, also rendering it uncertain whether the US will be able to adhere to the BCBS timeline. Our concern is that an uncoordinated approach to the implementation of the market risk capital charges jurisdiction by jurisdiction leads to divergence and regulatory fragmentation and, consequently, implementation challenges for globally active banks.

We greatly appreciate the opportunity to share our views on the Consultation Paper. Please do not hesitate to contact John Ball on +852 2531 6512, jball@gfma.org or Victoria Cumings on +1 212 313 1141, email vcumings@gfma.org, should you have any questions or wish to discuss any of the above.

Yours sincerely,

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