APAC Monthly Update

January 2012

APAC Monthly Update summarizes important regulatory developments, meetings, committee activities and conferences in the region.

Committee/Working Group Activities

North Asia L&R

On January 31, ISDA held its monthly L&R meeting in Hong Kong. At the meeting, ISDA briefed members on the latest regulatory and documentation developments in this region. Topics discussed regarding North Asia include China's Renminbi QFII pilot regime launched in January 2012, ISDA's submission to SAFE regarding the circular on RMB FX combined options, HKMA's circular on selling of investment products and HKMA's consultation paper on Basel III capital and liquidity ratios. Latest regulatory developments in South Asia and other ISDA efforts and documentation projects were also discussed at the meeting.

South Asia L&R

On January 26, ISDA held its monthly L&R meeting in Singapore. At the meeting, ISDA briefed members on the latest regulatory and documentation developments in this region. Some of the topics discussed for South Asia included the Australian submissions on 'Handling and Use of Client Money in relation to Over-the-Counter Derivatives Transactions and 'Review of Financial Market Infrastructure Regulation', ISDA's memos on the Summary of FEMA Impact on Collateralizing OTC Derivatives and ISDA's working group on RBI's Comprehensive Guidelines on Derivatives, an update on the Indian CDS market and India's draft guidelines for Basel III. Other topics covered included an update on the Indonesian Currency Law, the Malaysian Securities Commission's response to ISDA's submission on the Capital Markets and Services 9Amendment) Act 2011 and MAS's consultation paper on implementing the Basel III Capital Reforms. Latest regulatory developments in North Asia and other ISDA efforts and documentation projects were also discussed at the meeting.

Market Infrastructure

On January 5, ISDA held a APAC Interest Rates Derivatives Operations Working Group meeting to address a number of floating rate options draft for KRW, INR, AUD, CNY, the replacement of a NZD rate page, holiday monitoring and also the electronic confirmation format of onshore CNY swaps.

On January 18, ISDA held a meeting to discuss the incorporation of compounding and in arrears swap to the Asian NDS template.

On January 19, ISDA held a APAC Equity Derivatives Operations Working Group meeting to address the counterparty on-boarding issue, the documentation of local taxes in China H-stock, MSCI swap and Pan-Asia interdealer swap.

Regulatory Developments

Hong Kong:
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On January 20, the Hong Kong Monetary Authority (HKMA) issued two consultation papers, Implementation of Basel III Capital Standards in Hong Kong and Implementation of Basel III Liquidity Standards in Hong Kong. These documents are the first in a series of consultation papers which the HKMA intends to issue for seeking the banking industry's feedback on its proposals to implement Basel III.

For Capital Standards: as a general principle, the HKMA proposes to adopt the Basel III requirements into the Banking (Capital) Rules (BCR) unless there are strong justifications in the local context for not doing so. In implementing the Basel III capital standards, the HKMA intends to follow the transitional timeline as set by the Basel Committee. The HKMA proposes to replace the existing categories of regulatory capital with the new Basel III classification and to follow closely the Basel III definitions for individual components within each of the two tiers of capital. However, where existing BCR regulations are more stringent than Basel III or not directly comparable to it, a policy decision will be made on whether to retain the current approach or to align the relevant regulation to Basel III. The new capital requirements will be phased in from January 1, 2013 to January 1, 2015. The Capital Conservation buffer of 2.5% will be phased in from January 1, 2016 and fully implemented by January 1, 2019. For the calculation of the Credit Valuation Charge (CVA) capital charge, HKMA proposes to make available both the advanced and standardized methodologies as stated by the Basel Committee. Deadline for submission is March 20, 2012.

Other aspects of the Basel III Capital Standards, such as the capital buffers, leverage ratio and disclosure requirements will be subject to future consultations.

For Liquidity Standards: HKMA is introducing the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR). There will be a two-tiered approach to the application of the liquidity standards in Hong Kong. For the first tier, the LCR and NSFR will apply to a group of authorized institutions (AIs) (regardless of their place of incorporation) that are at the core of the Hong Kong banking system on the basis of their systemic importance and the nature of their operations (Category 1 AIs). The second tier, a modified version of the existing Liquidity Ratio (LR) in the Banking Ordinance (Modified Liquidity Ratio, MLR) will apply to other AIs with simpler operations and/or relatively less systemic implications for Hong Kong's banking system. A set of criteria will be developed to determine which AIs should be classified as Category 1 AIs. HKMA's rationale is that the LCR is fundamentally different from the LR and cannot be regarded as a complete substitute for the MLR in all circumstances.

HKMA is proposing that a Category 1 AI's LCR should be subject to a floor amount for their high quality liquid assets, which is equal to 25% of the AI's 1-month qualifying liabilities (net of deductions) as calculated under the MLR. The LR is essentially a broad-brush liquidity buffer requirement more directed towards providing for unexpected withdrawals or other day-to-day contingencies. For example: an AI would need to ensure there are liquefiable assets to meet withdrawals of up to 25% of such deposits without differentiating between the type and stability of deposits. The LCR, on the other hand, is subject to a narrow set of highly liquid asset types and other stringent qualifying criteria and is subject to stress parameters. HKMA is proposing changes to certain aspects of the LR, while preserving the simple structure of the ratio and its minimum level of 25%. The LCR will be implemented by January 1, 2015 and the NSFR by January 1, 2018. Deadline for submission is March 20, 2012.

Other aspects of the Basel III Liquidity Standards, such as the proposed approach to calibration of certain LCR items and definitional issues will be subject to future consultations.

India

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On December 30, 2011 Reserve Bank of India (RBI) released draft guidelines on the Implementation of Basel III Capital Regulations. The minimum Common Equity Tier 1 (CET1) ratio will be 5.5%, Total Tier 1 capital will be 7%, Total capital (Tier 1 + Tier 2) will be 9%. A Capital Conservation Buffer of 2.5% will be applied, so banks would be required to hold a total of 11.5% of capital. The transitional arrangements will begin on January 1, 2013 with the full implementation by March 31, 2017. The Basel III framework will be applicable to both the consolidated banks (Group) as well as at the stand-alone (Solo) level for banks operating in India. Overseas operations of a bank through its branches will be covered in both scenarios.

Some of the regulatory adjustments/ deductions highlighted in the paper are as follows: Goodwill and all other intangible assets will be deducted from Common Equity Tier 1 instead of Tier 1. Deferred Tax Assets (DTAs) will be deducted from Tier 1 capital under certain conditions. Cash Flow Hedge Reserve will be derecognized in the calculation of CET1. Banks are required to derecognize in the calculation of CET1 capital, all unrealized gains and losses, resulting from changes in fair value of liabilities due to changes in the bank's own credit risk. The regulatory adjustments would be fully deducted from CET1 only by March 31, 2016. The Current Exposure Method (CEM) will be used to calculate counterparty credit risk. Additionally, banks will be required to compute an additional capital charge to cover the risk of mark-to-market losses on the expected counterparty credit risk, i.e., credit valuation adjustments (CVAs). Bilateral netting of counterparty exposures is not permitted in India.

At present, the average leverage ratio of the scheduled commercial banks in India is above 5%. During the parallel run period from January 1, 2013 to January 1, 2017, banks should strive to maintain the existing level of leverage ratio. The final leverage ratio requirement will be prescribed by RBI after the parallel run, taking into account the prescriptions given by the Basel Committee. Banks will need to report their Tier 1 leverage ratio to RBI along with detailed calculations of capital and exposure measures on a quarterly basis from the quarter ending December 31, 2012. Guidelines on the Countercyclical Capital Buffer and the new global Liquidity Standards will be issued separately. Deadline for comments/ suggestions is February 15, 2012.

Indonesia:

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On December 6, 2011, the Ministry of Finance (MoF) published a Socialization Booklet and held a discussion on the Currency Law. This is not legislation per se, but it does suggest that application of the Currency Law will, in practice, be limited to situations where payments in Indonesia are made in cash. Article 21 of the law provides that Rupiah must be used for (a) each transaction involving payment; (b) settlement of other financial obligations; and/or (c) other financial transactions conducted within Indonesia. However, according to the MoF Socialization, Article 21 should apply only to transactions with cash payments involving bank notes and coins, and should not apply to transactions involving other forms of payments, such as letter of credits or electronic payments. This will limit the relevance of the law for major business transactions.

Article 23 prohibits anyone from refusing to accept Rupiah payment where such payment relates to the payment of a Rupiah obligation and/or other financial transaction in Indonesia, unless there is doubt to the authenticity of the Rupiah; or the relevant parties have agreed in writing to make the payment/settlement in a foreign currency. The MoF implicitly acknowledges that parties should have contractual freedom but the freedom of contract principle should not "legalize" the use of foreign currencies in Indonesia to the extent it results in the Rupiah being weakened. Hence, there still exists ambiguity on the interpretation of the "payments/settlement of obligations in foreign currency that have been agreed in writing." ISDA submitted comments to the Ministry of Finance and Bank Indonesia seeking further clarification on the ambiguities surrounding the Currency Law.

Philippines:
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The Bangko Sentral Ng Pilipinas (BSP) announced on January 6 that the country's universal and commercial banks, including their subsidiaries and quasi-banks, will be required to adopt the Basel III capital adequacy standards starting January 1, 2014. The BSP will adopt the standards in full with no staggered implementation or gradual phase-out of ineligible instruments. The minimum Common Equity Tier 1 (CET1) ratio will be 6%, Total Tier 1 capital will be 7.5%, and total capital (Tier 1 + Tier 2) will be 10%. A Capital Conservation Buffer of 2.5% will be applied. Full details of the capital adequacy guidelines will be issued in a consultation draft to be released in the first quarter of this year, with the view to finalize the guidelines by the third quarter, and a one-year parallel run before implementation in 2014. Other aspects of the Basel III implementation, such as leverage, liquidity and the Countercyclical Buffer, will also be announced this year.

Singapore:
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On December 28, 2011, the Monetary Authority of Singapore (MAS) released a consultation paper on the proposed amendments to MAS Notice 637 on Risk Based Capital Requirements for Banks Incorporated in Singapore (the notice), to implement the Basel III capital reforms. The deadline for comments is February 17. The Basel III framework will be applicable to both the consolidated banks (Group) as well as at the stand-alone (Solo) level for banks. The minimum Common Equity Tier 1 (CET1) ratio will be 6.5%, Total Tier 1 capital will be 8%, Total capital (Tier 1 + Tier 2) will be 10%. The phase-in period will begin from January 1, 2013 with full implementation by January 1, 2015. A Capital Conservation Buffer of 2.5% will be applied, with the phase-in beginning January 1, 2016 and full implementation by January 1, 2019. A Countercyclical Buffer of 2.5%, comprising of CET1 capital will be applied from January 1, 2019. The Leverage Ratio of 3% will be applied, in accordance with the Accounting Standards and calculated using the Current Exposure Method.

Some of the regulatory adjustments/deductions highlighted in the paper are as follows: Goodwill and all other intangible assets will be deducted from CET1 instead of Tier 1. Deferred Tax Assets (DTAs) that rely on the future profitability of the bank shall be deducted from CET1. Intra-entity netting of DTAs against Deferred Tax Liabilities (DTLs) for any banking group entity incorporated or established outside Singapore and inter-entity netting of DTAs against DTLs will not be allowed. Cash Flow Hedge reserve that relate to the hedging of items that are not fair valued on the balance sheet, such as projected cash flows, will be derecognized in the calculation of CET1 capital. All unrealized fair value gains/ losses on financial liabilities arising from changes in the credit risk of a bank/ banking group entity will be derecognized in the calculation of CET1 capital. The phase-in period will begin from January 1, 2013 with full implementation by January 1, 2018.

A bank will calculate its Credit Valuation Adjustment (CVA) for OTC derivatives transactions using the CVA advanced method or the CVA standardized method as stipulated in the MAS Notice 637. Only hedges with external counterparties will be recognized as CVA risk mitigants in the calculation of the CVA risk capital requirements.

Submission

January 17: ISDA submission to China's State Administration of Foreign Exchange on the Notice on Banks' RMB FX Combined Option Business

January 20: ISDA submission to the Australian Treasury on consultation paper "Handling and use of client money in relation to over-the-counter derivatives transactions"

Upcoming committee and working group meetings/conferences

Meetings:

APAC IRD Operation Working Group Meeting	Feb 2
APAC L&R Advisory Meeting	Feb 7
APAC Commodity Meeting	Feb 10
APAC Equity Operation Working Group Meeting	Feb 16
L&R South Asia Meeting	Feb 23
Implementation Group Meeting	Feb 27
L&R North Asia Meeting	Feb 28

Conferences:

Collateral Initiatives Symposium: Considerations in Standardizing Credit Support Annex Terms – Hong Kong	Feb 9
Collateral Initiatives Symposium: Considerations in Standardizing Credit Support Annex Terms – Singapore	Feb 13
Legal Aspects of Clearing Conference – Hong Kong	Feb 21

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