Annex 14

Supervisory Review of Advanced Capital Measurement Approaches

1. Application for Implementation

A commercial bank shall prepare for implementation of advanced capital measurement approaches pursuant to the requirements specified herein, submit to the CBRC the implementation application where appropriate, and start the implementation thereof after being granted the approval. The application for implementation of advanced capital measurement approaches shall be made at both the level of the banking group and the level of commercial bank as a single legal entity, and the approval will also be granted at both levels. The commercial bank can submit the application for implementation of advanced capital measurement approaches and internal capital adequacy assessment procedures separately based on the bank’s level of progress towards implementation.

1.1 Governance Structure

1.1.1 A commercial bank shall set up a sound organizational structure concerning the implementation application, define the roles, responsibilities and authorities of the Board of Directors, senior management, leading department and other departments involved, develop internal procedures concerning the implementation application, and have in place effective decision-making mechanisms and reporting processes, so as to ensure the application is carried out effectively.
1.1.2 The Board of Directors shall take ultimate responsibility for the preparation and application for implementation and compliance with eligibility criteria. The Board shall perform the following responsibilities:

1.1.2.1 To review and approve the plan for the implementation of advanced capital measurement approaches and material adjustments thereof;

1.1.2.2 To review and approve implementation application report and make sure application documents are authentic, reliable and complete; and

1.1.2.3 To regularly listen to briefing on the preparation for implementation, understand material impacts the implementation of advanced capital measurement approaches will have on the bank’s strategy, capital management and risk management, and timely learn about relevant information.

1.1.3 The senior management shall be responsible for organizing the bank to prepare for the implementation, make application and work to comply with eligibility criteria. It shall perform the following responsibilities:

1.1.3.1 To approve the procedures for application, define the roles and responsibilities of various departments involved, and monitor the progress of various projects on an ongoing basis;

1.1.3.2 To establish regular internal communication and reporting mechanisms, listen to briefings on implementation preparation, application and compliance status, and fully understand the overall status, progress of various projects and main gaps;
1.1.3.3 To organize the bank to support the on site assessment and check conducted by the CBRC; and

1.1.3.4 To develop rectification plans and monitor the implementation of the plans according to the outcome of the CBRC assessment.

1.1.4 A commercial bank shall assign a department to be responsible for coordinating and advancing the implementation preparation and application. Such department shall perform the following responsibilities:

1.1.4.1 To lead the preparation and application;

1.1.4.2 To lead self-assessment of compliance with eligibility criteria;

1.1.4.3 To organize departments involved to give briefings on the preparation, application and compliance status to the Board of Directors and senior management;

1.1.4.4 To take the specific responsibility of organizing the bank to support on-site assessment and check conducted by the CBRC; and

1.1.4.5 To organize the implementation of rectification plans and report the status of rectification.

1.1.5 Departments involved shall carry out tasks concerning the preparation, application and compliance, based on the banks’ overall plan and under the organization of the leading department. These participating departments shall perform the following responsibilities:

1.1.5.1 To provide documents required for application;

1.1.5.2 To regularly conduct self-assessment on the compliance with eligibility criteria within their own roles and responsibilities, and
provide assessment results and necessary support to the lead department;

1.1.5.3 To give regular briefings on the progress of preparation to the Board of Directors and senior management;

1.1.5.4 To support on-site assessment and check conducted by the CBRC; and

1.1.5.5 To implement the rectification plans concerning their own departments according to the recommendations and requirements of the CBRC.

1.2 Submission of Application

1.2.1 Prior to application, a commercial bank shall be assessed by the CBRC with regard to its preparation for implementation. The documents submitted by the bank for the purpose of assessment shall include:

1.2.1.1 Description of overall situation, including but not limited to the scope of application, objectives of application and overview of preparation work;

1.2.1.2 Supporting documents, including but not limited to documents related to governance structure, policies and procedures, measurement models, data and information systems and scope of use. Among others, records approved by the Board of Directors or senior management shall be submitted as far as key definitions of advanced capital measurement approaches and important matters are concerned;

1.2.1.3 The latest self-assessment report for compliance;

1.2.1.4 Results of at least the latest two quantitative impact study;
1.2.1.5 Validation report and auditing report; and

1.2.1.6 Other documents that can help the CBRC understand the status of implementation preparation.

1.2.2 Where a commercial bank develops and maintains measurement models through outsourcing, it shall provide the CBRC with information needed for overall assessment through appropriate means.

1.2.3 After rectifications being reviewed and recognized by the CBRC, the commercial bank may submit the application for implementation, and the application documents shall include but are not limited to:

1.2.3.1 Application for implementation. The application shall clarify the scope and objectives of application;

1.2.3.2 Relevant decisions concerning the implementation application that are reviewed and approved by the Board of Directors or the committee authorized by the Board; and

1.2.3.3 The documents for assessment as required in Part 2 “Submission” that are updated as of the date of application.

1.3 Implementation Application at the Level of Banking Group

1.3.1 The banking group headquarters shall be responsible for the group level preparation and organization for implementation application, file application to the CBRC for implementation and obtain the approval from the CBRC for implementation at the level of banking group.

1.3.2 The banking group shall define the scope of implementation application, including subsidiaries to be covered and their shares of assets
Where an entity is not included in the application but plans another application in the future for being included in scope of implementation at the level of banking group, the implementation plan and current status shall be submitted; For an entity not to be included in the scope of implementation at the level of banking group, a description of the reasons shall be submitted.

1.3.3 In addition to meeting the requirements specified in above “Submission of Application” on assessment documents and application materials, the banking group shall also submit to the CBRC documents describing the approaches adopted by the various legal entities operating under the group and the differences thereof, and provide empirical data to illustrate the impact of such differences on the consistency of risk management of the group as well as corresponding solutions and actual effects thereof.

2. Supervisory Approval

2.1 General Approval

2.1.1 The CBRC will be responsible for reviewing and approving the implementation of advanced capital measurement approaches and internal capital adequacy assessment procedures (ICAAP) of commercial banks pursuant to the Rules.

2.1.2 In the course of reviewing and approving, the CBRC will focus on the following aspects:

2.1.2.1 Analyzing the role of advanced capital measurement approaches in improving the bank’s risk management;
2.1.2.2 Reviewing whether the bank has established self-improving mechanisms to promote continuous improvements of risk management;

2.1.2.3 Assessing whether the bank has met the supervisory requirements concerning the adoption of advanced capital measurement approaches; and

2.1.2.4 Checking whether the validation of advanced capital measurement approaches is sufficient and effective.

2.1.3 Basis on the documents submitted by the commercial bank, the CBRC will develop assessment plan, carry out the assessment, evaluate the overall status of the bank’s implementation preparation, and urge the bank to make corrections if necessary.

2.1.4 According to the assessment results and corrections of the problems identified, the CBRC will determine whether the bank can officially submit the application for implementation.

2.1.5 The CBRC’s review and approval processes are as following:

2.1.5.1 Examine and assess the authenticity and integrity of application materials;

2.1.5.2 Develop approval plan and carry out on-site check. According to the results of assessment on the bank’s implementation preparation and follow-up corrections, the CBRC will comprehensively analyze various documents submitted by the bank to determine the approval plan, and the onsite check will focus on areas not covered by the assessment and corrections of the problems identified by the CBRC during the assessment;
2.1.5.3 Prepare the approval report. The approval report will focus on analyzing the current implementation status of the bank, existing problems and shortfalls, and parallel run arrangements, and finally conclude with preliminary approval recommendations.

2.1.5.4 Provide feedback for approval opinions. The CBRC will communicate with the bank’s senior management about the preliminary approval opinions, so as to verify and confirm facts with them.

2.1.5.5 Sign and issue approval opinions. If a bank is granted with conditional approval for implementation, the CBRC shall provide the bank with a list of specific items to be corrected and improved for meeting eligibility criteria during the parallel run period; and

2.1.5.6 Ongoing monitoring and control. For commercial banks that are ready for implementation, the CBRC will continuously monitor and control the corrections during the parallel run period.

2.1.6 When reviewing and approving the implementation of advanced capital measurement approaches, the CBRC has the right to, in light of the results of assessment and check, ask the commercial bank to adjust long-term average default tendency, loss at given default during recessions, correlation coefficient, valid maturity and other important parameters of its internal rating-based approach for measuring credit risks, make adjustments to additional factors and other important parameters of its internal market risk models approach, and make adjustments to its advanced operational risk measurement approach, so as to ensure the measurement results fully capture the actual risk profiles.

2.1.7 Should the check shows that a commercial bank’s preparation for implementation has fully met the supervisory requirements, the CBRC
can grant the bank with approval for implementation of advanced capital measurement approaches. Should the bank fail to fully meet the supervisory requirements but has met eligibility criteria concerning core items that have substantial impact on the implementation and has in place plans to meet eligibility criteria during the parallel run period in areas where non-substantial shortfalls exist, the CBRC can grant the bank with conditional approval for implementation.

A commercial bank failing to obtain the approval shall make improvements according to the correction requirements set forth by the CBRC and can apply again after getting permissions from the CBRC.

2.2 Cross-border Approval

2.2.1 The CBRC takes primary responsibilities for reviewing and approving the application by banking groups. It shall actively work with the host supervisors to reach consensus on approval opinions. Where no consensus can be reached, the CBRC shall come to final approval opinions by adopting the opinions of related host country supervisors.

2.2.2 As for overseas subsidiaries managed centrally by the banking group headquarters, the CBRC shall take leading role in the reviewing and approving processes.

As for overseas subsidiaries taking up substantial market shares in the host jurisdiction, the CBRC will invite the host supervisor to take part in the review and approval; as for other overseas subsidiaries, the CBRC will share approval information with host supervisors by means of supervisory college mechanism and provision of approval results and so on.
2.2.3 As for overseas subsidiaries whose implementation approaches are quite different from the banking group or who are responsible for global management of certain business line(s), the host supervisors will lead the review and approval. The CBRC will discuss joint approval, take part in the approval or share important approval information with the host supervisors through bilateral supervisory collaboration mechanism.

Where the host supervisor does not have in place bilateral supervisory collaboration mechanisms with the CBRC or where the information they provide is limited, the banking group shall provide information about the overseas subsidiaries concerning the status of application and approval according to the CBRC requirements.

2.2.4 As for a wholly foreign-funded bank that have substantial market shares in China, the CBRC will lead the review and approval and have discussions with its home supervisors about its participation into the examination and approval.

As for other foreign-funded banks, the CBRC will discuss joint approval, take part in the approval or share important approval information with the home supervisors through bilateral supervisory collaboration mechanisms.

2.2.5 As for a wholly foreign-funded banks whose implementation approaches are quite different from its banking group as a whole or who are responsible for global management of certain business line(s), the CBRC is responsible for the review and approval.

Where host supervisors do not have in place bilateral supervisory collaboration mechanisms with the CBRC or where the information they provide is limited, the wholly foreign-funded banks shall provide
information about the wholer banking group concerning the status of application and approval according to the CBRC requirements.

3. Arrangements during Parallel Run Period

3.1 The CBRC will set a parallel run period for the commercial bank approved to implement advanced capital measurement approaches. The parallel run period shall at least last for 3 years, starting from 31 December of the year when the CBRC grants the approval to the bank.

During the parallel run period, if the commercial bank granted with conditional approval for implementation fails to fulfill the corrections as per the supervisory requirements, or its internal adequacy ratio assessment procedures are not approved, the CBRC can appropriately extend the parallel run period.

During the parallel run period, if a commercial bank transits from FIRB to AIRB for credit risk, from standardized approach to internal models’ approach for market risk, or from standardized approach to AMA for operational risk, the parallel run period shall be extended for 3 years starting from 31 December of the year when the new approach is approved.

3.2 The commercial bank granted with conditional approval for implementation shall develop detailed plans for comprehensively meeting eligibility criteria, submit to the CBRC reports on the implementation of said plans every six months, support the CBRC in examinations and assessments, and make sure it will fully meet the supervisory requirements upon expiry of the parallel run period.

3.3 A commercial bank shall submit an application for ending the parallel run period six month prior to the expiry thereof and can end said period only when granted with the CBRC approval. The submission shall meet the requirements specified in above “Submission of Application” hereof.
3.4 During the parallel run period, a commercial bank shall calculate capital adequacy ratios under both advanced capital measurement approaches and other approaches, and abide by the capital floor requirements.

3.5 Calculation of aggregate risk weighted assets:

3.5.1 Calculation of capital floor requirement under other approaches:

\[ Cs = (\text{RWAs} \times \text{CAR} + Ds - \text{EPs}) \times \alpha \]

Where:

Cs is the capital requirement constrained by capital floor;

RWAs is the aggregate risk weighted assets calculated under other approaches;

CAR is the sum of minimum capital requirement and conservation buffer requirement;

Ds is the total of capital deductions calculated pursuant to the Rules under other approaches;

EPs is the excess loan loss provisions eligible for inclusion in capital calculated pursuant to the Rules under other approaches;

\( \alpha \) is the capital floor adjustment coefficient. The coefficient is 95% for the first year, 90% for the second year and 80% for the third year and beyond of the parallel run period.

3.5.2 Calculation of capital requirements under advanced capital measurement approaches

\[ Ca = \text{RWAA} \times \text{CAR} + \text{Da} - \text{EPa} \]
Where:

Ca is the capital requirement for one or more of the three types of risks, i.e. credit risk, market risk and operational risk, under advanced capital measurement approaches for calculation of risk weighted assets;

RWAa is the aggregate risk weighted assets calculated pursuant to the Rules partially or entirely under advanced capital measurement approaches;

Da is the total of capital deductions calculated pursuant to the Rules under other advanced capital measurement approaches;

EPa is the excess loan loss provisions eligible for inclusion in capital calculated pursuant to the Rules under advanced capital measurement approaches.

3.5.3 Calculation of aggregate risk weighted asset during the parallel run period

\[ RWA = \max(\text{Cs} - \text{Ca} \, , \, 0) \times \text{CAR} - 1 + \text{RWAa} \]

Where, RWA is the aggregate risk weighted assets during the parallel run period.

4. Ongoing Supervisory Review

4.1 The CBRC will conduct ongoing supervisory review on the prudence of a commercial bank’s advanced capital measurement approaches, so as to make sure the measurement results fully capture the adverse impact of various economic and policy environment changes on expected and non-expected losses.


4.2 Where a commercial bank makes material adjustments to its advanced capital measurement approaches, including but not limited to expanded scope of coverage, adjusted key definitions and important parameters, reconstructed or adjusted measurement models, etc., the bank shall timely submit a report to the CBRC in conjunction with an overall validation report and analysis report for quantitative impact estimation.

Based on the bank’s validation and measurement results, the CBRC will decide whether on-site assessment is necessary and whether it will grant approval for such adjustments.

4.3 The CBRC will learn about the operation of a commercial bank’s advanced capital measurement approaches by reviewing the bank’s validation reports and other off-site surveillance means,

A commercial bank shall submit the validation report to the CBRC at least once a year. The validation report should help the CBRC to understand the operation, validation and modification of advanced capital measurement approaches. The CBRC can ask the commercial bank to provide detailed explanations of the validation reports submitted.

4.4 The CBRC will conduct supervisory review on a commercial bank’s validation of advanced capital measurement approaches pursuant to the Rules, including:

4.4.1 Reviewing the establishment and implementation of internal validation system concerning advanced capital measurement approaches;

4.4.2 Assessing the rationality and applicability of the validation methods adopted by the commercial bank;

4.4.3 Assessing the reliability of the bank’s validation data management processes, information system and validation activities;
4.4.4 Reviewing whether the bank’s validation covers all validation activities as required by the Rules;

4.4.5 Assessing the bank’s implementation of validation triggering mechanism and response mechanism;

4.4.6 Reviewing the utilization of validation results and correction of problems identified during the validation; and

4.4.7 Reviewing whether the bank has validated relevant documents and assessed the validity of such documents.

4.5 Should the advanced capital measurement approaches implemented by a commercial bank have severe deficiencies, including but not limited to measurement results lower than capital requirements, validation failing to constantly meet supervisory requirements, the CBRC shall ask the commercial bank to make corrections within a given time period. Should the bank fail to meet supervisory requirements upon expiry of the given time period, the CBRC has the right to revoke the bank’s qualification for implementation of advanced capital measurement approaches.

Among others, if the measurement results under the internal models’ approach for market risk include 10 outliers within recent 250 trading days, the bank concerned shall immediately report to the CBRC and the CBRC shall then ask the bank to make corrections and set a 6-month observation period. During the observation period, if the bank fails to make effective corrections, the CBRC shall revoke the bank’s qualification to adopt the internal models’ approach for market risk.

4.6 The commercial bank whose qualification for implementation of advanced capital measurement approaches is revoked by the CBRC may not apply to the CBRC for implementation of advanced capital measurement approaches within 3 years after the date of revocation.