

Process Review Committee

Annual Report to the Financial Secretary 2010-2011

I. GENERAL INFORMATION

Background of establishment

1.1 The Clearing and Settlement Systems Ordinance (CSSO), which came into effect on 4 November 2004, empowers the Monetary Authority (MA) to designate and oversee clearing and settlement systems that are material to the monetary or financial stability of Hong Kong or to its functioning as an international financial centre. The purpose of the CSSO is to promote the general safety and efficiency of designated clearing and settlement systems.

1.2 Since enactment of the CSSO, six clearing and settlement systems have been designated. They are:

- (a) the Central Moneymarkets Unit (CMU)
- (b) the Hong Kong Dollar Clearing House Automated Transfer System (HKD CHATS)
- (c) the US Dollar Clearing House Automated Transfer System (USD CHATS)
- (d) the Euro Clearing House Automated Transfer System (EUR CHATS)
- (e) the Renminbi Clearing House Automated Transfer System (RMB CHATS)
- (f) the Continuous Linked Settlement (CLS) System

1.3 The system operator (SO) and settlement institution (SI) of each designated system are set out in the following table:

Table 1:

	Designated System					
	CLS System	CMU	HKD CHATS	USD CHATS	EUR CHATS	RMB CHATS
System operator	CLS Bank	HKMA	HKICL*	HKICL*	HKICL*	HKICL*
Settlement institution	CLS Bank	Nil	HKMA	HSBC	Standard Chartered Bank (Hong Kong) Ltd	Bank of China (Hong Kong) Ltd

* The Hong Kong Monetary Authority (HKMA) and the Hong Kong Association of Banks each own 50% of the Hong Kong Interbank Clearing Limited (HKICL)

1.4 Of the six designated systems, the CLS system is the only one in which the HKMA does not have any interest. The CLS system is subject to the supervision of the U.S. Federal Reserve and is exempted under section 11 of the CSSO from the HKMA's oversight. The HKMA exercises ongoing oversight of the remaining five designated systems; the CMU, HKD CHATS, USD CHATS, EUR CHATS and RMB CHATS, and has an interest in all of them in one way or another. Some of these designated systems have established links with overseas payment or securities settlement systems to facilitate cross-border transactions, for example, the RENTAS¹ – USD CHATS payment-versus-payment (PvP) and delivery-versus-payment (DvP) links, and the BI-RTGS² – USD CHATS PvP link. Although these overseas systems are not overseen by the HKMA, the HKMA oversees these external links in coordination with the respective home overseers.

1.5 To address the potential or perceived conflict of interest arising from the HKMA both being the system operator or settlement institution of certain systems on

¹ RENTAS is the RTGS clearing and settlement system for inter-bank fund transfer and scripless securities trading in Malaysia.

² BI-RTGS is the RTGS clearing and settlement system for inter-bank fund transfer in Indonesia

one hand and the overseer of designated systems on the other, the HKMA has implemented a number of measures. These include a clear segregation of duties within the HKMA and the promotion of transparency in the designation and oversight processes. In addition, the Process Review Committee (PRC), an independent, non-statutory committee, was established by the Chief Executive of the Hong Kong Special Administrative Region in December 2004 to review the processes and procedures adopted by the HKMA in applying oversight standards. It seeks to, among other things, ensure that the same set of standards is applied to all designated systems, whether or not the HKMA has an interest in them.

Scope of work and terms of reference

1.6 The terms of reference of the PRC are:

- (a) to review and advise the HKMA upon the adequacy of the HKMA's internal operational procedures and guidelines for applying the standards set under the CSSO to those designated systems in which the HKMA has a legal or beneficial interest;
- (b) to receive and consider periodic reports from the HKMA on all completed or discontinued files in respect of alleged non-compliance of the CSSO by those designated systems in which the HKMA has a legal or beneficial interest; and
- (c) to submit annual reports and, if appropriate, special reports on designated systems in which the HKMA has a legal or beneficial interest, to the Financial Secretary.

1.7 The PRC has agreed that, in discharging its functions, the Committee would focus on whether there were any discrepancies in the HKMA's oversight of systems in which the HKMA has an interest, as compared with other systems. In other words, the PRC would review the processes and procedures adopted by the HKMA to ensure that the same oversight standards were applied to all designated systems. This is consistent with the policy intention of the establishment of the PRC.

1.8 The PRC is required to submit annual reports and, if appropriate, special reports to the Financial Secretary. The Financial Secretary may cause the reports to be published subject to relevant confidentiality requirements.

Membership of the PRC

1.9 The PRC is in its third term of service. Members of the PRC are appointed by the Chief Executive of the Hong Kong Special Administrative Region in their personal capacity for a three-year term from 1 December 2010 to 30 November 2013. The membership of the PRC as at 30 November 2011 was:

Chairman

Prof Andrew Chan Chi Fai, SBS, JP

Director, EMBA Programme
Professor, Department of Marketing
Chinese University of Hong Kong

Members

Mr Chan Kay Cheung

Vice-Chairman
Bank of East Asia (China) Limited

Prof Stella Cho Lung Pui Lan

Dean and Professor
Division of Business and Management
United International College
Beijing Normal University-Hong Kong Baptist University

Mr Nicholas Peter Etches

Certified Public Accountant

Mr Mervyn Robert John Jacob

Financial Services Leader, Hong Kong and China
PricewaterhouseCoopers

Ms Judy Wong Sau Pik

Partner, Assurance

Ernst & Young

II. HIGHLIGHTS OF THE WORK OF THE PRC

2.1 This is the seventh Annual Report of the PRC, which covers the work of the Committee from 1 December 2010 to 30 November 2011. This is also the first annual report for the current PRC.

Meetings held and major deliberations of the PRC

2.2 The PRC held two meetings in 2011. At the first meeting in June, Members reviewed the regular report covering the oversight activities of the HKMA from December 2010 to March 2011. In particular, Members discussed how the HKMA handled the abnormal events encountered by the designated systems.

2.3 As the June meeting was the first PRC meeting for most of the Members including the Chairman, Members were briefed on the background to the Clearing and Settlement Systems Ordinance (CSSO) and its main provisions. The approach and processes of the HKMA in conducting oversight of designated systems under the CSSO and the reasons for establishing the PRC were explained to Members. A copy of the Internal Operating Manual was sent to them. Members agreed on the established approach of the PRC, including reviewing the regular reports to check whether the HKMA has applied the same oversight standards and procedures to all designated systems.

2.4 At the second meeting held in November, Members reviewed the regular report covering the period from July to September 2011. They also commented on the drafting of the Committee's seventh annual report to be submitted to the Financial Secretary.

2.5 As agreed by Members, regular reports covering the HKMA's oversight activities are sent to Members for review by circulation in between meetings. If Members have questions about the reports, they may raise them with the Secretary of the Committee. Subject to the agreement of the Chairman, the questions will be discussed at the next meeting or, if needed, a special meeting will be held.

2.6 Four regular reports were circulated to Members for review in 2011. Members noted that the HKMA met the performance benchmarks for oversight activities.

Comments and recommendations of the PRC

2.7 The format of the regular report and the accompanying oversight activities management reports were designed based on suggestions from Members. During the year, Members reviewed four regular reports and 24 accompanying oversight activities management reports covering the period from December 2010 to November 2011. Statistics showing the oversight activities contained in each regular report under the review of the PRC are summarised below:

Table 2: Oversight activities of HKMA under the review of PRC from Dec 2010 to Nov 2011

HKMA's oversight activities conducted during the quarter	1st Regular Report (Dec- Mar)	2nd Regular Report (Apr-Jun)	3rd Regular Report (Jul-Sep)	4th Regular Report (Oct-Nov)
Processing of monthly return submitted by SO/SI	36	27	27	18
Vetting of changes in particulars of SO/SI	4	13	10	5
Reviewing of ad-hoc information submitted by SO/SI	61	24	29	18
Granting approval to changes in operating rules	16	9	5	5
Conducting on-site examinations	0	1	0	0
Handling of abnormal events/ production incidents	10	3	6	3
Handling of contravention cases	0	0	0	0
Holding of meetings with management of SO/SI	3	0	0	2

2.8 At the meeting in June 2011, Members discussed the handling of a number of abnormal events relating to the USD CHATS – BI-RTGS PvP link. Members noted that the smooth operation of the PvP link relied on the robustness of Hong Kong's and Indonesia's respective payment systems, and all the incidents resulted from problems originating from the Indonesian side. The payment systems oversight team of the HKMA maintained close contact with its BI's oversight counterparts to monitor the situation. The performance of the link became more stable in the second half of 2011.

2.9 At the meeting in November, Members noted that the HKMA had conducted an on-site examination of the RMB CHATS in June 2011, focusing on the cross-border remittance and fiduciary account services provided by the RMB SI. Members discussed a number of abnormal events related to the SWIFTNet platform on which the designated systems operate, and noted the follow-up actions taken by the HKMA with SWIFT.

2.10 A draft of the annual report was discussed at the meeting in November 2011. Members had no comments on the draft. Members agreed to adopt the same publication approach as for the previous annual reports. The PRC would propose to the Financial Secretary that the annual report be published in its entirety and be posted on the website of the HKMA for wider dissemination to the public in the interests of promoting transparency and accountability.

III. CONCLUSION AND WAY FORWARD

3.1 During the period, the PRC reviewed four regular reports and 24 accompanying oversight activity management reports covering the period from December 2010 to November 2011. No complaints were received from the SOs and the SIs and no alleged contravention events were noted during the period. The review covered, among other things, submissions by the HKMA on its processing of 108 monthly returns and 32 cases of changes in particulars, granting approvals to 35 changes in operating rules, handling of 22 abnormal events and production incidents, reviewing of 132 submissions of ad-hoc information and holding of 5 meetings with the management of the SOs and the SIs.

3.2 The PRC was not aware of any cases where the HKMA had not followed duly the internal operational procedures, or where the HKMA had not been procedurally fair in carrying out its oversight activities across different designated systems.

3.3 The PRC will continue to review the processes and procedures adopted by the HKMA in overseeing the existing designated systems and, where appropriate, additional systems that will be overseen by the HKMA under the CSSO in the coming years.