

Process Review Committee

Annual Report to the Financial Secretary 2015-2016

I. GENERAL INFORMATION

Background of establishment

1.1 The Payment Systems and Stored Value Facilities Ordinance (PSSVFO)¹ 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 or having regard to matters of significant public interest. The purpose of the PSSVFO is, among other things, to promote the general safety and efficiency of designated clearing and settlement systems (CSS).

1.2 To date, six CSS have been designated under the PSSVFO. 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 The PSSVFO commenced operation on 13 November 2015, after the Clearing and Settlement Systems Ordinance (CSSO) was amended to include a designation regime for retail payment systems and a licensing regime for stored value facilities. The amended CSSO was retitled as the PSSVFO on the same date. The designation, certificate of finality and any exemptions granted to designated CSS under the pre-amended CSSO continue to have effect under the PSSVFO. The oversight regime of the designated CSS remains substantially the same under the PSSVFO, except that the MA has more enforcement powers.

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

Table 1:

	Designated CSS					
	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 The HKMA is the owner/operator of HKD CHATS and the CMU and has a 50% stake in Hong Kong Interbank Clearing Ltd. (HKICL), which is the system operator of the four CHATS systems and provides computer support to the CMU (The Hong Kong Association of Banks (HKAB) holds the other 50% of shares in HKICL). Of the six designated CSSs, the CLS system is the only one in which the HKMA does not have an interest. The CLS system is subject to the supervision of the Federal Reserve Bank of New York (New York Fed) and is exempted under section 11 of the PSSVFO from certain requirements under the Ordinance. The New York Fed leads a CLS Oversight Committee with representatives from all of the jurisdictions (including Hong Kong) whose currencies are members of the CLS system and the HKMA exercises oversight of CLS through this forum. The HKMA exercises on-going oversight of the five local designated CSSs: the CMU, HKD CHATS, USD CHATS, EUR CHATS and RMB CHATS. Some of these designated CSSs have established links with overseas payment or securities settlement systems to facilitate cross-border transactions, for example, the RENTAS² – USD CHATS payment-versus-payment

² RENTAS is the RTGS clearing and settlement system for inter-bank fund transfer and scripless securities trading in Malaysia.

(PvP) and delivery-versus-payment (DvP) link, the BI-RTGS³ – USD CHATS PvP link and the BAHTNET⁴ – USD CHATS PvP link. Although these overseas systems are not overseen by the HKMA, the HKMA oversees these external links in cooperation with the respective home overseers.

1.5 The HKMA has implemented a number of measures to address the potential or perceived conflict of interest arising from the HKMA being the system operator or settlement institution of certain CSSs and also the overseer of designated CSSs. 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. Among other things, it seeks to ensure that the same set of standards is applied to all designated CSSs, 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 are⁵:

- (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 PSSVFO 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 PSSVFO by those designated systems in which the HKMA has a legal or beneficial interest; and

³ BI-RTGS is the RTGS clearing and settlement system for inter-bank fund transfer in Indonesia.

⁴ BAHTNET is the RTGS system for large value fund transfer between financial institutions or other organizations in Thailand.

⁵ The terms of reference was amended in 2015 to reflect the change of the name of the Ordinance from CSSO to PSSVFO. Designated system means either a designated clearing and settlement system or a designated retail payment system under the PSSVFO.

- (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 should focus on whether there were any discrepancies in the HKMA's oversight of designated CSSs 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 CSSs. The PRC also agreed that its scope could be expanded in future if the HKMA had a legal or beneficial interest in a designated retail payment system (RPS) or a licensed stored value facility (SVF) under the PSSVFO. This is consistent with the policy intention of the establishment of the PRC in 2004.

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 fourth 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 2013 to 30 November 2016. The membership of the PRC as at 30 November 2016 was:

Chairman

Prof Andrew Chan Chi Fai, SBS, JP

Director, EMBA Programme

The 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

Ms Joan Ho Yuk Wai

Certified Public Accountant

Ms Judy Wong Sau Pik

Partner, Assurance
Ernst & Young

II. HIGHLIGHTS OF THE WORK OF THE PRC

2.1 This is the 12th Annual Report of the PRC, which covers the work of the Committee from 1 December 2015 to 30 November 2016.

Meetings held and major deliberations of the PRC

2.2 The PRC held two meetings in 2016. At the first meeting in August, Members reviewed the regular report covering the oversight activities of the HKMA from April to June 2016. In particular, Members discussed how the HKMA handled the abnormal events encountered by the designated CSSs. Members were also briefed on the progress of implementation of the Principles for Financial Market Infrastructures (PFMI) in Hong Kong and the issuance of two statutory guidelines by the HKMA in May 2016 under the PSSVFO regarding the latest oversight requirements of the designated CSS.

2.3 At the second meeting held in December, Members reviewed the regular report covering the period from July to September 2016, and were briefed on the oversight activities conducted by the HKMA during October and November. They commented on the drafting of the Committee's 12th annual report to be submitted to the Financial Secretary.

2.4 As agreed by Members, regular reports covering the HKMA's oversight activities are sent to Members for review by circulation 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.

2.5 Four regular reports were circulated to Members for review in 2016. Members noted that the HKMA had met the performance benchmarks for oversight activities.

Comments and recommendations of the PRC

2.6 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 22 accompanying oversight activities management reports covering the period from December 2015 to November 2016. 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 2015 to Nov 2016

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	17	9	6	0
Reviewing of ad-hoc information submitted by SO/SI	56	38	33	25
Granting approval to changes in operating rules	12	7	5	4
Conducting on-site examinations	0	1	0	0
Handling of abnormal events/ production incidents	18	8	14	14
Handling of contravention cases	0	0	0	0
Holding of meetings with management of SO/SI	5	0	0	1

2.7 At the meeting in August, Members noted that Hong Kong is participating in the Level 2 assessments of the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions (CPMI-IOSCO) monitoring of implementation of the PFMI.⁶ The PFMI are the latest international

⁶ Hong Kong had fully adopted the PFMI and achieved the highest ratings in the Level 1 assessment, which examines whether jurisdictions have made regulatory changes to reflect the Principles and

standard for overseeing financial market infrastructures. The Level 2 assessments focus on whether, and to what degree, the content of the legal and regulatory framework, including rules and regulations, and any relevant policy statement or other forms of implementation applied to each jurisdiction, was complete and consistent with the PFMI. Both the HKMA and SFC were involved in the exercise, with HKMA as the co-ordinating party. Both authorities were filling in questionnaires to be assessed by CPMI-IOSCO in due course.

2.8 Members noted that the HKMA had issued two statutory guidelines in May 2016 under the PSSVFO. The first one was a revised guideline on “Oversight Framework for Designated Clearing and Settlement Systems” to reflect the new provisions in the PSSVFO (e.g. power of MA to request for information or documents relating to the system from participants, to require report to be prepared by auditor, and to investigate and impose sanctions). The second one was a new guideline on “Application of Principles for Financial Market Infrastructures to Designated Clearing and Settlement Systems” to adopt the requirements in the PFMI down to the Key Considerations level.

2.9 At the meeting in December, Members noted that the Level 2 assessments mentioned at the last PRC meeting had been completed. The HKMA had obtained the highest ratings in all relevant areas under its purview. The assessment report would be published in the first quarter of 2017. Members noted that the issuance of a new oversight guideline (see paragraph 2.8) to adopt the PFMI down to the Key Considerations level (rather than just at Principles level) had contributed to the favourable ratings received.

2.10 A draft of the annual report was discussed at the meeting in December 2016. 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 22 accompanying oversight activity management reports covering the period from December 2015 to November 2016. No complaints were received from the SOs and 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 28 changes in operating rules, handling of 54 abnormal events and production incidents, reviewing of 152 submissions of ad-hoc information and holding of 1 meeting 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 CSSs and, when appropriate, any additional systems or stored value facilities that may be overseen or supervised by the HKMA under the PSSVFO in the coming years.