

# **Process Review Committee**

## **Annual Report to the Financial Secretary 2016-2017**

### **I. GENERAL INFORMATION**

#### **Background of establishment**

1.1 The Payment Systems and Stored Value Facilities Ordinance (PSSVFO)<sup>1</sup> 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 (CSSs).

1.2 To date, six CSSs 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

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<sup>1</sup> 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 CSSs under the pre-amended CSSO continue to have effect under the PSSVFO. The oversight regime of the designated CSSs remains substantially the same under the PSSVFO, except that the MA has more enforcement powers.

1.3 The system operators (SOs) and settlement institutions (SIs) of the designated CSSs are set out in the following table:

**Table 1:**

	<b>Designated CSS</b>					
	<b>CLS System</b>	<b>CMU</b>	<b>HKD CHATS</b>	<b>USD CHATS</b>	<b>EUR CHATS</b>	<b>RMB CHATS</b>
<b>System operator</b>	CLS Bank	HKMA	HKICL*	HKICL*	HKICL*	HKICL*
<b>Settlement institution</b>	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 the 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 (FRBNY) and is exempted under section 11 of the PSSVFO from certain requirements under the Ordinance. FRBNY 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 payment-versus-payment (PvP) and delivery-versus-payment (DvP) link between USD CHATS and RENTAS<sup>2</sup> in

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

Malaysia, the PvP link between USD CHATS and BI-RTGS<sup>3</sup> in Indonesia and the PvP link between USD CHATS and BAHTNET<sup>4</sup> in Thailand. 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 SO or SI 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 (CE/HKSAR) 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 are<sup>5</sup>:

- (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

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

<sup>4</sup> BAHTNET is the RTGS system for large value fund transfer between financial institutions or other organisations in Thailand.

<sup>5</sup> 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 (FS).

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. So far, the HKMA had not acquired any interest in any designated RPS or licensed SVF under the PSSVFO.

1.8 The FS may cause the reports submitted by the PRC to be published, subject to relevant confidentiality requirements.

## **Membership of the PRC**

1.9 The PRC is in its fifth term of service. Members of the PRC are appointed by the CE/HKSAR in their personal capacity for a three-year term from 1 December 2016 to 30 November 2019. The membership of the PRC as at 30 November 2017 was:

### Chairman

**Professor Francis Chin Yuk-lun**

Chair Professor, Department of Computing

Director, Deep Learning Research and Applications Centre

Hang Seng Management College

Emeritus Professor, University of Hong Kong

### Members

**Ms Annie Chan Wai-hing**

Managing Director  
Mazars Corporate Recovery & Forensic Services Limited

Ms Joan Ho Yuk-wai  
Certified Public Accountant

Ms Sabita Prakash  
Managing Director  
Asia Debt Management Hong Kong Limited

Mr Michael Shue  
Chairman  
Hong Kong Trustees' Association Ltd

## **II. HIGHLIGHTS OF THE WORK OF THE PRC**

2.1 This is the 13<sup>th</sup> Annual Report of the PRC, which covers the work of the Committee from 1 December 2016 to 30 November 2017. This is also the first annual report for the current term of the PRC.

### **Meetings held and major deliberations of the PRC**

2.2 The PRC held two meetings in 2017. At the first meeting in July, Members reviewed the regular report covering the oversight activities of the HKMA from December 2016 to March 2017 and was briefed on the oversight activities conducted by the HKMA from April to June 2017. In particular, Members discussed how the HKMA handled abnormal events encountered by the designated CSSs.

2.3 As the July meeting was the first PRC meeting for most of the current term Members including the Chairman, Members were briefed on the background and main provisions of the PSSVFO as well as the role of the PRC. Members were also briefed on the approach and processes of the HKMA in conducting oversight of designated CSSs under the PSSVFO and the reasons for establishing the PRC. A paper setting out the background and explaining the latest update of the Internal Operating Manual of the HKMA was also presented to Members. 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 CSSs.

2.4 At the second meeting held in November, Members reviewed the regular report covering the period from July to September 2017, and was briefed on the oversight activities conducted by the HKMA from October and November 2017. They also discussed the drafting of the Committee's 13<sup>th</sup> annual report to be submitted to the FS.

2.5 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 regular meeting or, if needed, at a special meeting.

2.6 Four regular reports were circulated to Members for review in 2017. Members noted that the HKMA had 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 36 accompanying oversight activities management reports covering the period from December 2016 to November 2017. 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 2016 to Nov 2017**

<b>HKMA's oversight activities conducted during the quarter</b>	<b>1<sup>st</sup> Regular Report (Dec- Mar)</b>	<b>2<sup>nd</sup> Regular Report (Apr-Jun)</b>	<b>3<sup>rd</sup> Regular Report (Jul-Sep)</b>	<b>4<sup>th</sup> Regular Report (Oct-Nov)</b>
Processing of monthly return submitted by SO/SI	36	27	27	18
Vetting of changes in particulars of SO/SI	15	13	5	2
Reviewing of ad-hoc information submitted by SO/SI	43	27	41	26
Granting approval to changes in operating rules	0	4	5	4
Conducting on-site examinations	0	0	0	2
Handling of abnormal events/ production incidents	13	13	5	2
Handling of contravention cases	0	0	0	0

Holding of meetings with management of SO/SI	6	0	0	0
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2.8 At the meeting in July, Members were updated on the issues relating to cyber security of the designated CSSs. HKICL as the SO of the designated CSSs and being a utility in the banking sector was in the process of implementing a cyber resilience program to evaluate and reinforce its cyber security. These efforts encompassed the Cyber Resilience Assessment Framework issued by the HKMA to the banking sector and the Customer Security Program issued by the Society for Worldwide Interbank Financial Telecommunication (SWIFT). The latter was relevant because the designated systems all use a SWIFT-based messaging platform.

2.9 At the meeting in November, Members discussed a draft of the annual report. Members had no comments on the draft and agreed to adopt the same publication approach as for the previous annual reports. The PRC would propose to the FS 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 36 accompanying oversight activity management reports covering the period from December 2016 to November 2017. 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 35 cases of changes in particulars, granting of approvals to 13 changes in operating rules, handling of 33 abnormal events and production incidents, reviewing of 137 submissions of ad-hoc information and holding of 6 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, where appropriate, any additional designated systems or licensed SVF under the PSSVFO in which the HKMA has a legal or beneficial interest.