Banking Stability

The prospect of asset purchases reduction in the US brought about volatility in financial markets in 2013, highlighting market concerns over possible deterioration of liquidity conditions and fund outflows. To guard against the potential adverse impact on the banking sector, the HKMA continued to take proactive steps to ensure banking stability. During the year, the sixth round of prudential measures on property mortgage loans was introduced. A Stable Funding Requirement was introduced to ensure loan growth by authorized institutions (AIs) is supported by sufficient stable funds. The HKMA also stepped up its supervision of Mainland-related business and anti-money laundering controls. The year also saw the implementation of the first phase of the Basel III capital standards and the associated disclosure requirements. To enhance consumer protection, the HKMA also rolled out a consumer education programme and launched the Treat Customers Fairly Charter.

REVIEW OF 2013

Overview

Amid uncertainties over fiscal issues and economic recovery in the US and Europe, volatilities in emerging markets and increased risk in the local property market, the HKMA continued to monitor closely AIs' management of credit and liquidity risks, Mainland-related business, property-related lending and stress-testing to ensure the resilience of the banking sector against any abrupt changes in the macroeconomic environment.

Operational supervision

In 2013, the HKMA carried out 282 on-site examinations. Resources were also deployed to work related to the International Monetary Fund's (IMF) assessment of the HKMA's compliance with the *Core Principles for Effective Banking Supervision* under the Financial Sector Assessment Programme (FSAP), as well as more in-depth thematic examinations of AIs' Mainland-related activities given their increased significance and the systemic risk they could pose to the Hong Kong banking sector. The HKMA also conducted thematic examinations of property-related lending and asset quality. Based on the examination scope determined for individual AIs, risk-based examinations reviewed, as appropriate, AIs' general credit and operational risk management, the adequacy and effectiveness of their compliance, legal and internal audit functions, corporate governance and remuneration systems.

The HKMA conducted more on-site examinations of the effectiveness of AIs' risk management and regulatory compliance in specialised areas compared with 2012, such as stress-testing and liquidity risk, prevention of money laundering and terrorist financing and technology and operational risk. AIs' activities in securities, investment products, insurance and Mandatory Provident Fund-related businesses were also subject to on-site examinations by specialist teams during the year. Details of specialised examinations are given in the subsequent sections.

The HKMA also continued to conduct on-site reviews of the redeveloped internal models of AIs which have been given approval to adopt the Foundation or Advanced Internal Ratings-based (IRB) approach for calculating credit risk capital charge.

One hundred and ninety-three off-site reviews were conducted to assess AIs' financial position and business operations. Supervisory attention focused on AIs' credit growth, in particular cross-border trade finance activities, and the associated impact on asset quality, liquidity and funding positions. The supervisory teams maintained contact with the boards of directors and external auditors of selected AIs. Meetings were held with the full board or board-level committees of 15 AIs and tripartite meetings with the senior management and external auditors of nine AIs.

The Banking Supervision Review Committee considered seven cases, four concerning authorization of AIs, two relating to the investigation of conduct issues of AIs arising from banking operations other than regulated activities, and one relating to an application to become a shareholder controller of an AI.

To better utilise its supervisory resources on competing priorities, the HKMA made increased use of powers under section 59(2) of the Banking Ordinance to require AIs to appoint external auditors to follow-up on potentially material supervisory issues. The HKMA commissioned seven reports under this provision in 2013. Four of these reports covered anti-money laundering and counter-terrorist financing (AML/CFT) control systems and the remaining three were related to other control issues, such as operational risk management, governance frameworks and securities-related activities.

No AI breached the requirements of the Banking Ordinance relating to capital adequacy in 2013. There was one breach of the requirement under section 102 relating to the liquidity ratio, 11 under section 20(4)(b) on notification to the HKMA of a change to information recorded in the register maintained by the HKMA, three under section 65 on notification to the HKMA of alterations to memorandum or articles of association, three under section 72A(2A) on notification to the HKMA of a change of specified persons within 14 days, and three under section 72B on notification to the HKMA of the appointment of managers. All the breaches were assessed to be unintentional. They were rectified promptly by the relevant AIs and did not affect the interests of depositors.

Table 1 Operational supervision

		2013	2012
1	On-site examinations	**282**	288
	Regular examinations	**56**	73
	– risk-based	**47**	58
	– overseas	**9**	15
	Reviews of the internal ratings-based approach (IRB approach) and internal models approach (IMM approach)	**12**	22
	– Initial recognition assessment and follow-up examinations of the IRB approach	**9**	15
	– Recognition of major system changes and follow-up examinations of the IMM approach	**3**	7
	Capital planning	**4**	7
	Credit risk management and asset quality	**33**	34
	Market risk and treasury activities	**2**	9
	Firm-wide stress testing and liquidity risk management	**41**	13
	Securities, investment products, insurance and Mandatory Provident Fund-related businesses	**24**	27
	Compliance with the Deposit Protection Scheme Ordinance and Deposit Protection Scheme Representation Rules	**12**	12
	Code of Banking Practice/Consumer Protection	**3**	2
	Positive mortgage data sharing	**2**	3
	Anti-money laundering/counter-terrorist financing controls	**19**	14
	IT, Internet banking and operational risk	**40**	20
	Mainland-related business	**31**	15
	Renminbi business	**3**	37
2	Off-site reviews and prudential interviews	**193**	192
3	Tripartite meetings	**9**	13
4	Meetings with board of directors or board-level committees of AIs	**15**	19
5	Approval of applications to become controllers, directors, chief executives or alternate chief executives of AIs	**225**	199
6	Reports commissioned under section 59(2) of the Banking Ordinance	**7**	1
7	Cases considered by the Banking Supervision Review Committee	**7**	7
8	AIs subject to the exercise of powers under section 52 of the Banking Ordinance	**1**	1

Powers under section 52 of the Banking Ordinance

Melli Bank Plc continues to be subject to the exercise of powers under section 52 of the Banking Ordinance. The directions imposed by the Monetary Authority on 25 June 2008 under section 52(1)(A) of the Banking Ordinance on the affairs, business and property of the Hong Kong Branch of Melli Bank Plc remained in force during the year. The HKMA will continue to communicate regularly with the relevant authorities to monitor developments related to the branch and its head office in the UK and will keep in view the supervisory measures taken to protect the interests of the AI's depositors.

CAMEL rating review

The CAMEL Approval Committee reviewed and determined the composite CAMEL ratings[1] of AIs. The AIs were notified of the ratings and given the opportunity to request a review, although none did so.

Specialised supervisory work

Supervision of technology risk

The use of Internet banking services continued to grow in 2013. By the end of the year, the number of personal Internet banking accounts reached 8.8 million (from 8.4 million in 2012), and there were 788,000 corporate Internet banking accounts (up from 764,000 in 2012).

Regular on-site examinations and off-site surveillance of AIs' controls over Internet banking, technology risk management and business continuity planning were conducted. Coverage of the independent compliance assessment (formerly called supervisory control self-assessment) process for Internet banking, technology risk management and business continuity planning was extended to 90 AIs (from 79 in 2012). The HKMA also conducted desktop reviews and thematic examinations of 61 AIs to assess the adequacy of their independent compliance assessment processes.

[1] Comprising the **C**apital adequacy, **A**sset quality, **M**anagement, **E**arnings and **L**iquidity components.

The HKMA continued to monitor the industry's implementation of chip-based ATM technology to strengthen security controls for ATM services. All ATM terminals in Hong Kong have been upgraded to support chip-based authentication and ATM card replacement will be completed in phases by the end of 2015. Continued efforts were also made to increase public awareness of the new ATM security measures through the Consumer Education Programme launched by the HKMA in late 2013.

Public awareness of Internet banking security was again featured in the HKMA's promotional efforts in collaboration with other entities. This included participating in the "Build a Secure Cyberspace" campaign organised by the Hong Kong Police Force, the Office of the Government Chief Information Officer and the Hong Kong Computer Emergency Response Team Co-ordination Centre to raise awareness of cyber threats and highlight the importance of information security.

Supervision of operational risk

The annual self-assessment on operational risk management covered 78 AIs in 2013 (74 in 2012). In general, the exercise showed the AIs concerned had established operational risk management frameworks in line with the supervisory requirements. A specialist operational risk management team conducted on-site examinations at three AIs to review their policies and controls on operational risk.

Supervision of securities, investment products, insurance and Mandatory Provident Fund-related businesses

Throughout the year, the HKMA co-operated closely with the Securities and Futures Commission (SFC), the Office of the Commissioner of Insurance (OCI) and the Mandatory Provident Fund Schemes Authority in supervising AIs' businesses related to securities, insurance and Mandatory Provident Fund (MPF). Regular contact was maintained through bilateral and multilateral meetings, and under the auspices of the Council of Financial Regulators.

Because of the low interest rate environment, yield enhancement products such as high-yield bonds and high-yield bond funds have become popular among investors. As a result, the HKMA issued a circular in August highlighting a number of key principles to provide further guidance to Registered Institutions (RIs) regarding the product risk rating of high-yield bonds, high-yield bond funds and related products. The HKMA expects RIs to adopt robust methodologies and a prudent approach in assessing product risk and assigning risk ratings to such products.

During the year, the HKMA collaborated with the OCI, the SFC and the Hong Kong Federation of Insurers to introduce measures to enhance disclosure relating to the sale of investment-linked assurance scheme (ILAS) products. Under the new requirements, AIs and other insurance intermediaries selling ILAS products were required, by the end of June 2013, to implement an Important Facts Statement (IFS) requesting customers to set out their reasons and considerations for procuring such products. Starting from the same date, the HKMA also required AIs to make written pre-sale disclosure of monetary and non-monetary benefits receivable by the AI or any of its associates from the insurance company for distributing the ILAS product. This is in line with the requirement currently applicable to the sale of other investment products by AIs and aims to help customers make meaningful comparisons when deciding whether to invest in ILAS or other investment products. Another measure arising from the HKMA's collaboration with the SFC and the OCI was the enhanced disclosure requirements in the ILAS Product Key Facts Statement, introduced by the SFC in May.

In April, the HKMA issued a circular to the banking industry describing some common issues on customer suitability assessment and product disclosure that were identified in its supervision of AIs' sale of ILAS products. It also published an *inSight* article drawing attention to how potential ILAS customers could benefit from the IFS. In addition, the HKMA and other relevant financial regulators provided advice to the Investor Education Centre (IEC) on educational materials published during the year to help the public better understand ILAS and the new regulatory measures.

To encourage healthy development of the private wealth management industry in Hong Kong, the HKMA worked with the industry to establish the Private Wealth Management Association (PWMA). One of the key objectives of the PWMA is to promote proper conduct, integrity and professional competence among private wealth management practitioners. The HKMA has worked closely with the PWMA, the Hong Kong Institute of Bankers (HKIB), the Hong Kong Securities and Investment Institute (HKSI) and the Treasury Markets Association (TMA) to develop an enhanced competency framework (ECF) for private wealth management practitioners. The ECF covers competence benchmarks and continuing professional development for private wealth management practitioners. Industry consultation on the proposed framework was completed in December, with the industry generally supportive of the proposed framework.

The HKMA instituted a mystery shopping programme in 2013 to assess AIs' compliance with regulatory requirements in selling investment and insurance products. A service provider was engaged to undertake the programme, and the field work has been completed. The HKMA will identify any industry-wide issues for sharing with the industry.

During the year, specialist teams conducted 24 on-site examinations covering the sale of investment products by private banks, product due diligence, selling processes and training regarding investment products, compliance with new or enhanced regulatory requirements, the sale of ILAS products and non-linked long-term insurance products, and the sale of MPF-related products. The HKMA also launched a new half-yearly survey on the sale of investment products to private banking customers, to be submitted by all RIs starting from 2014. The survey will show industry trends in these sales and facilitate the HKMA's off-site surveillance of such activities.

The HKMA processed five applications to become RIs and four applications from RIs to engage in additional regulated activities. It also granted consent to 230 executive officers, who are responsible for supervising the securities activities of RIs, and conducted background checks on 8,193 individuals whose information was submitted by RIs for inclusion in the register maintained by the HKMA.

The formulation of the future regulatory framework governing the distribution of insurance products, under the proposed independent Insurance Authority, continued during the year with the HKMA working closely with both the OCI and the Financial Services and the Treasury Bureau (FSTB).

Following the commencement of the statutory regime regulating MPF intermediaries on 1 November 2012 and the Employee Choice Arrangement, the HKMA carried out on-site examinations and off-site surveillance to assess AIs' compliance with the performance requirements under the regime.

Supervision of treasury activities

To assess AIs' compliance with the standards and guidance set out in the recently updated modules on "Sound Systems and Controls for Liquidity Risk Management" and "Stress-testing" in the Supervisory Policy Manual (SPM), the HKMA conducted 41 thematic on-site examinations at selected AIs in addition to on-site examinations of AIs' treasury and derivatives activities focusing on their control framework for managing market and counterparty credit risk.

The HKMA devoted considerable resources to monitoring and analysing financial market events with potentially significant or systemic implications for the banking industry and provided technical expertise on material or emerging risks in relation to AIs' treasury and derivatives operations.

Supervisor-driven stress testing programme

The HKMA initiated a bottom-up stress testing programme in late 2012 to better understand the resilience of locally incorporated retail banks under extreme adverse economic conditions, and to encourage them to develop plans to address potential problems in case economic conditions come under stress. The HKMA has analysed the stress test results prepared by the participating AIs and discussed with them how their stress testing processes could be further improved.

Credit risk management and asset quality

Credit growth and asset quality

The banking sector's total lending increased by 16%, compared with 9.6% in 2012 (Table 2). As loan growth outpaced that of customer deposits, the overall loan-to-deposit ratio increased to 70.4% at the end of 2013 from 67.1% a year ago. The overall asset quality of the banking sector remained sound with the classified loan ratio standing at 0.54% at the end of the year.

Table 2 Growth in loans and advances

% change	**2013**	2012
Total loans and advances	**16.0**	9.6
Of which:		
– for use in Hong Kong	**10.6**	7.0
– trade finance	**43.8**	9.1
– for use outside Hong Kong	**21.5**	15.9

Stable Funding Requirement

In view of the low interest rate environment and the rising loan-to-deposit ratio, the HKMA continued to monitor AIs' lending practices to ensure their credit underwriting standards remained prudent. While the overall liquidity of Hong Kong's banking system remained stable in 2013, there were rising concerns that liquidity conditions might deteriorate when the US started to taper its quantitative easing policy. The HKMA introduced a Stable Funding Requirement in October 2013 to ensure AIs could maintain stable business operations continuously when market liquidity came under stress. Banks with higher rates of loan growth are required to arrange sufficient stable funds as liquidity support.

Prudential supervision of mortgage loans

There were renewed signs in early 2013 of the property market heating up as quantitative easing measures of the major central banks intensified. The HKMA introduced on 22 February further countercyclical macroprudential measures to:

(1) increase the mortgage rate upward adjustment used for stress-testing property mortgage loan applicants' debt-servicing ability from at least two percentage points to at least three percentage points;

(2) lower the applicable loan-to-value (LTV) ratio limits for all commercial and industrial property mortgages by 10 percentage points; and

(3) limit the maximum LTV and debt-servicing ratio (DSR) for stand-alone car park space mortgage loans to the levels applicable to commercial and industrial property mortgage loans, and limit the maximum loan tenor to 15 years.

To ensure that AIs maintain a higher level of regulatory capital as a cushion against risks arising from their residential mortgage lending activities, the HKMA also introduced a 15% risk-weight floor for all new residential mortgage loans (RMLs) granted after 22 February 2013 by AIs that have been approved to adopt the IRB approach for calculating the credit-risk capital charge.

The six rounds of macroprudential measures introduced since October 2009 have strengthened the resilience of AIs to the potential impact of a property market downturn. The average LTV ratio for new RMLs declined to 54% in December 2013 from 64% in September 2009 before the first round of these measures was introduced. The average DSR for new RMLs decreased to 35% in December 2013 from 41% in August 2010 when the tighter DSR requirement was introduced.

Separately, it was noticed that some money lenders were engaging in mortgage lending. Since most money lenders are not regulated by the HKMA, they are not required to follow the HKMA's prudential measures. As these mortgage lending activities may undermine the effectiveness of HKMA's prudential measures, the HKMA has requested AIs to review their policy for providing loans to money lenders to ensure the effectiveness of the HKMA's measures.

So far, property mortgage loans extended by these money lenders were very limited, estimated to be around 1% of total RMLs of the banking sector. Nevertheless, as the mortgage underwriting standards of money lenders can be rather relaxed, the HKMA will closely monitor the activities of these money lenders and their potential impact on bank's mortgage business.

European sovereign debt crisis and US tapering

While policies introduced by international organisations and European authorities have reduced the risk of a European sovereign debt crisis, risks to economic growth in the European Union remain. The HKMA is monitoring developments to ensure foreign AIs, particularly those from Europe, have sound funding and liquidity positions. It has also communicated with the home supervisors of some European AIs to discuss matters of supervisory interest through teleconferences, bilateral meetings, supervisory colleges and crisis management groups.

On 18 December, the US Federal Reserve announced it will, starting from January 2014, reduce the amount of debt securities purchased each month from US$85 billion to US$75 billion. The pace of further reductions in asset purchases, and when these purchases will cease and interest rates will normalise, remain uncertain. In the near term, market volatility is likely to continue as financial markets react to changes in US economic conditions and adjust expectations about further adjustments to the asset purchase programme. The HKMA has taken steps to contain the potential adverse impact of unprecedented monetary easing policies and required AIs to be prudent in managing their liquidity and interest rate risks to cater for possible fund outflows.

Mainland-related business

Renminbi banking business

In view of the improving liquidity in the offshore renminbi foreign exchange and money markets and the sound and sustained development of renminbi business in Hong Kong, the HKMA took additional steps to provide greater flexibility for AIs in managing and developing this business. In April, the HKMA removed the renminbi Net Open Position Limit and the 25% renminbi minimum liquidity ratio. The conditions prescribed in February 2012 regarding the application of renminbi liquefiable assets for the calculation of the statutory liquidity ratio were also lifted. With these relaxations, the regulatory requirements for AIs' management of foreign exchange and liquidity risks in renminbi business are in line with those applicable to other currencies.

Tapping the Mainland market

Thirteen locally incorporated banks have established business operations on the Mainland, of which eight operate through subsidiary banks incorporated on the Mainland. These banks continued to expand their branch networks during the year, maintaining over 440 Mainland branches or sub-branches, either directly or through subsidiaries. The HKMA conducted on-site examinations of these subsidiary banks and their major branches in Mainland China.

The industry's aggregate on-balance-sheet non-bank exposures to the Mainland amounted to the equivalent of HK$3,161.3 billion at the end of 2013, or 17.3 % of total assets. These included exposures of HK$773.4 billion booked at Mainland subsidiaries of Hong Kong banks. Compared with 2012, the aggregate on-balance sheet exposures grew by 30.6%.

With the increasing Mainland-related business conducted by AIs, the HKMA stepped up surveillance of these activities and introduced a new Quarterly Return of Mainland Activities, requiring all AIs to report more granular information on their non-bank Mainland exposures, with the first report to cover their position at the end of September 2013.

Following a noticeable increase in Mainland-related trade financing activities, the HKMA, in June, requested the internal audit functions of AIs active in this business to conduct thematic review to verify the adequacy and effectiveness of their risk management and internal controls for such activities. Where deficiencies were identified, the HKMA required AIs to take remedial action within a reasonable timeframe for less serious problems or, where more significant issues were found, to commission an independent external party with relevant expertise to conduct a more in-depth review of the trade financing activities.

Prevention of money laundering and terrorist financing

To ensure AIs' systems and controls are effective and comply with the legal and regulatory requirements, the HKMA progressively strengthened the resources of its AML specialist teams and conducted 19 on-site examinations in 2013.

Earlier in the year, the HKMA conducted seminars for the Chief Executives and other senior management of AIs to reiterate the importance of senior oversight and a strong risk culture to AML/CFT. Annual AML/CFT seminars were also held to provide training for a wider audience of industry practitioners.

The HKMA issued a guidance paper on transaction screening, monitoring and suspicious transaction reporting that was developed in collaboration with the industry and the Joint Financial Intelligence Unit. A circular was issued in June reminding AIs of the importance of effective controls against tax evasion.

The HKMA continued to participate in various international and regional forums for AML/CFT, including the Financial Action Task Force, the Asia/Pacific Group on Money Laundering and the AML/CFT Expert Group established by the Basel Committee.

Co-operation with overseas supervisors

The HKMA participated in college-of-supervisors meetings organised by the home supervisors of 19 banking groups with significant operations in Hong Kong. Issues of common interest were discussed, including market trends, key areas of supervisory focus, stress testing, credit, liquidity, market, operation and other types of risk management and supervisory issues relating to megabanks.

Bilateral meetings were held with banking supervisory authorities from Australia, Canada, France, Germany, Indonesia, Japan, Macau, the Mainland, Malaysia, the Netherlands, Singapore, South Korea, Switzerland, Taiwan, the UK and the US to ensure effective co-operation and co-ordination. There were also regular exchanges with authorities outside Hong Kong on institution-specific issues and developments in financial markets.

The HKMA also participated in the crisis management groups of nine banking groups organised by the relevant home authorities to discuss and oversee the production of a recovery and resolution plan for each banking group in accordance with the principles established by the Financial Stability Board (FSB). As an FSB member, the HKMA contributed its views on the cross-border resolution framework as well as the co-operation protocol between home authorities and non-Crisis Management Group host authorities in the Cross-Border Crisis Management Working Group. The HKMA also organised jointly with the SFC and the Swiss Financial Market Supervisory Authority a two-day Recovery and Resolution Planning Workshop for the host regulators of two Swiss AIs from the Asia-Pacific region.

Basel III

Implementation of Basel III in Hong Kong

The HKMA implemented the first phase of the Basel Committee on Banking Supervision's Basel III capital standards and their associated disclosure requirements, with the Banking (Capital) (Amendment) Rules 2012 (BCAR 2012) and the Banking (Disclosure) (Amendment) Rules 2013 (BDAR 2013) coming into effect respectively on 1 January and 30 June 2013, in accordance with the Basel Committee's transition timetable.

Capital standards

Pillar 1

The first phase of the capital standards introduced in the BCAR 2012 enhanced the level and quality of AIs' regulatory capital base by introducing three revised risk-weighted minimum capital ratios (Common Equity Tier 1 capital ratio, Tier 1 capital ratio and Total capital ratio) computed using a more stringent definition of capital, and by broadening the coverage of the ratios for AIs' counterparty credit risk (CCR) exposures.

The capital positions of locally incorporated AIs remained strong under the new capital standards, with their Total capital ratios averaging well above the international minimum of 8% and the core part of their capital base being made up of common equity (about 80% of Total capital or 96% of Tier 1 capital)[2], the highest (in the sense of most loss-absorbing) form of regulatory capital under Basel III.

Further refinements were introduced into the Banking (Capital) Rules, through the Banking (Capital) (Amendment) Rules 2013, which took effect from 30 June 2013, to reflect further technical guidance issued by the Basel Committee in the form of frequently asked questions (FAQs) in late 2012. The HKMA also developed and issued in September 2013 a set of local FAQs to aid interpretation and facilitate understanding of the Basel Committee's technical guidance in the context of the local Banking (Capital) Rules.

In December, the HKMA issued a circular to all locally incorporated AIs regarding the retention, by AIs adopting the IRB approach for calculating their regulatory capital for credit risk, of capital floors beyond the first three years of IRB implementation. This reflects an earlier decision of the Basel Committee to keep the capital floors in place pending further discussion on any future permanent capital floors or benchmarks.

Pillar 2

To accommodate the implementation of Basel III in Hong Kong, the HKMA made certain changes to its "Supervisory Review Process" (SRP, the local Pillar 2 framework) and put the revisions into effect on 1 January 2013 following industry consultation. The changes to the SRP are principally designed to address any potential overlap between Pillar 2 capital requirements and the Basel III capital buffers when the latter come into effect in 2016. The basic concept underpinning the HKMA's SRP remains, however, that Pillar 2 capital is, and will continue to be, a constituent part of an AI's minimum regulatory capital requirements.

2 Capital position of AIs at the end of December 2013.

Basel III (continued)

Pillar 3

The disclosure requirements introduced in the BDAR 2013 are designed to enhance the consistency and comparability of capital disclosures among banks and across jurisdictions. To facilitate their implementation, the HKMA issued a set of standard disclosure templates in August 2013, prescribing the format for AIs' disclosures in relation to their capital base under the BDAR 2013. AIs with an interim financial period ending on 30 June 2013 are already subject to the amended rules for their Pillar 3 disclosures for that period.

Capital buffers

The second phase of implementation of the Basel III capital standards focuses on introducing the capital conservation and countercyclical capital buffers. These two buffers are designed to reinforce banks' resilience beyond the minimum capital requirements. The capital conservation buffer requires a bank to hold additional Common Equity Tier 1 capital equal to 2.5% of its risk-weighted assets if it is to avoid having restrictions placed on its ability to make certain distributions. The countercyclical capital buffer is designed to be "switched on" in times of excessive credit growth associated with the build-up of system-wide risks and "switched off" in a credit cycle downturn in order to help maintain the flow of credit to the real economy. The countercyclical buffer works by extending the range of the capital conservation buffer. Basel III provides for "jurisdictional reciprocity" with regard to the operation of the countercyclical buffer, meaning that individual bank regulators will require banks incorporated in their jurisdictions to calculate their countercyclical buffer requirements taking into account the countercyclical buffer rates applicable not only in their home jurisdictions but also in the other jurisdictions where they have private sector credit exposures. The buffers will be phased in between 2016 and 2018 in line with the transition timeline of the Basel Committee. Preparatory work was undertaken for the introduction of the necessary legislative amendments to the Banking (Capital) Rules and the Banking (Disclosure) Rules in 2014 to implement the two buffers.

National authorities will require frameworks for the surveillance of the build-up of systemic risk for the purposes of the countercyclical buffer. In an industry consultation paper issued in December 2013, the HKMA set out its proposed approach to assessing the build-up of systemic risk and implementing the countercyclical buffer in Hong Kong more generally and sought comments from the banking industry.

Liquidity standards

In addition to strengthening regulatory capital requirements, Basel III introduces two new global liquidity standards, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), to improve banks' resilience to liquidity stress[3]. A complementary set of liquidity monitoring tools has also been developed for supervisors' surveillance of bank's liquidity risk exposure to further strengthen and promote consistency in liquidity risk supervision globally.

In January 2013, the Basel Committee announced a package of revisions to the LCR, including:

(i) introduction of an additional category of "Level 2B assets" that may, at national discretion, be recognised as "high-quality liquid assets" (HQLA) under the LCR;

[3] The LCR is designed to promote banks' short-term liquidity resilience by ensuring that they have sufficient high-quality liquid assets to survive for at least 30 days under acute stress. The NSFR is designed to reduce funding risk over a longer time horizon of up to 1 year by requiring banks to fund their activities with sufficiently stable sources of funding in order to mitigate the risk of future funding stress.

Basel III (continued)

(ii) re-calibration of the stress assumptions for the outflow rates for retail and corporate deposits, committed credit and liquidity facilities, and repos with central banks;

(iii) affirmation of the usability of banks' HQLA in times of stress; and

(iv) introduction of a phase-in arrangement for the LCR, whereby national authorities may set the minimum LCR requirement at 60% on 1 January 2015, to be increased by 10 percentage points annually to reach 100% on 1 January 2019.

The NSFR was under review by the Basel Committee during 2013, but it remains the Committee's intention that the NSFR, including any revisions, should be implemented starting from 1 January 2018.

Since 2012, the HKMA has undertaken a series of industry consultations on the implementation of the Basel III liquidity standards in Hong Kong. The latest consultation in July 2013, which reflected the Basel Committee's revisions to the LCR and the industry comments from the previous consultations, closed in September. Having considered the comments received, the HKMA refined and communicated its policy proposals to the industry in December. These include:

(i) Adoption of a two-tiered approach to applying the liquidity standards

Larger and more sophisticated AIs will be classified by the HKMA as "Category One" institutions and be subject to the LCR, while other AIs will be classified as "Category Two" institutions and be subject to a modified version of the existing 25% minimum Liquidity Ratio. In determining the classification of foreign bank branches in Hong Kong, the HKMA will additionally consider the interplay between "group factors" affecting these branches (for example, group compliance with the Basel LCR and liquidity risk management standards) and other classification criteria.

(ii) Adoption of the Basel Committee's implementation timetable with the LCR being introduced in phases from 1 January 2015

The modifications to the Liquidity Ratio for Category Two institutions will also come into effect on 1 January 2015. The HKMA will seek to adopt the Basel liquidity risk monitoring tools from 2015 as part of its ongoing liquidity risk supervision.

(iii) Selective recognition of Level 2B assets under the LCR

Among the Level 2B assets defined by the Basel Committee, the HKMA will allow AIs to include as HQLA: non-financial corporate debt securities with a credit rating of A+ to A- and, subject to case-by-case approval, residential mortgage-backed securities (at least rated AA or above) that meet all relevant qualifying criteria. Other Level 2B assets (that is, listed common equities and triple-B rated non-financial corporate debt securities) will not be recognised given their higher price volatility and market liquidity risks.

(iv) Adoption of Alternative Liquidity Approaches allowed under the Basel framework

To address the limited supply of HQLA denominated in Hong Kong dollars, Category One institutions will be allowed to use foreign currency HQLA to cover Hong Kong dollar liquidity needs, subject to the application of usage limits

Basel III (continued)

and haircuts on such foreign currency HQLA as required by the Basel Committee.

(v) *Treatment of cash-flow items under the LCR*
The HKMA will generally follow the Basel requirements and, for those items where the local treatment is subject to national discretion, the HKMA intends to apply a 10% outflow rate for "less stable retail deposits"; a 5% outflow rate for "retail term deposits"; and a 3% outflow rate for "trade finance contingent funding obligations". These proposed treatments take account of local circumstances and the approaches adopted in other major jurisdictions.

(vi) *Major modifications to the existing Liquidity Ratio*
Net interbank placements (that is, net of interbank borrowings) maturing within one month will continue to be recognised as "liquefiable assets" under the modified ratio, subject to some restrictions to address residual liquidity risks. "Eligible loan repayments", on the other hand, will cease to be recognised as "liquefiable assets", but the liquidity value of such inflows will be allowed to offset "qualifying liabilities" in the denominator of the ratio.

The finalised liquidity proposals will form the basis for a set of Banking (Liquidity) Rules to be tabled in the Legislative Council (LegCo) in 2014 for implementation from 1 January 2015.

Leverage Ratio

An important area of regulatory reform introduced under Basel III is the establishment of a simple, non-risk-based leverage ratio, which is intended to serve as a complementary measure to the risk-based capital framework and to guard against the build-up of excessive leverage by banks. Under the Basel Committee's transition timetable, regulators are required to monitor banks' leverage ratios by reference to a 3% "testing minimum" in a "parallel run" period during 2013 to 2017. Any final adjustments to the definition and calibration of the leverage ratio will be carried out in 2017, with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration.

The HKMA consulted the banking industry on a reporting template for parallel run purposes in 2013 and will amend the template in response to a set of changes made by the Basel Committee to the final leverage ratio framework in January 2014.

SIFI framework

The Basel Committee and the FSB continued to work on the policy framework designed to address the systemic risks and moral hazard associated with systemically important financial institutions (SIFIs). Taking into account the lessons learnt from applying its assessment methodology to identify global systemically important banks (G-SIBs) in the past couple of years, the Basel Committee published an updated version of the G-SIB framework in July, to replace the original

Basel III (continued)

November 2011 publication. The latest version of the G-SIB framework includes disclosure requirements for banks above a certain size to enable the framework to operate on the basis of publicly available information.

The FSB has continued to publish annually a list of the G-SIBs identified under the Basel Committee's methodology. The latest list issued in November identified the "buckets" into which the G-SIBs fall for the purpose of assessing the additional higher loss absorbency capital requirements to be applicable to them. In addition, to ensure the transparency of the methodology, the "denominators" used to calculate the banks' scores, (that is, the aggregates of each of the 12 G-SIB indicators across the sample of banks), as well as the cut-off score and thresholds used to allocate the banks to their respective buckets were also published by the Basel Committee.

Supplementary guidance for Basel III implementation

The HKMA released in September a revised policy paper on the Recognition of External Credit Assessment Institutions (ECAIs) for the purposes of regulatory capital calculation under the Banking (Capital) Rules. The revisions, made after consultation with the banking industry and the ECAIs concerned, reflect the principle underlying Basel III that supervisory authorities should refer to the Code of Conduct Fundamentals for Credit Rating Agencies issued by the International Organization of Securities Commissions (IOSCO) when determining ECAI eligibility for regulatory capital calculation. The enhanced ECAI recognition criteria set out in the revised policy paper should ensure the external credit assessments used by AIs for regulatory capital calculations result from a rigorous rating process conducted by an ECAI, which is independent both organisationally and financially, and which provides adequate transparency in relation to its rating methodologies and the performance of its ratings. ECAIs currently recognised by the HKMA for regulatory capital purposes were requested to submit self-assessment reports on their compliance with the revised recognition criteria to the HKMA in November.

In addition, the HKMA issued in December an updated guideline on "Financial Instrument Fair Value Practices". It incorporates amendments relating to the full recognition, for regulatory capital purposes, of fair-value gains arising from fair-valued financial instruments as a component of "Common Equity Tier 1 capital" under Basel III. This contrasts with the position under Basel II where such gains were generally required to be excluded from Core Capital and included as Supplementary Capital with a 55% haircut. AIs are expected to ensure that all of their fair-value estimates are reliable and determined in accordance with applicable accounting standards and the supervisory guidance set out in the guideline.

Supervisory reporting

In April 2013, the HKMA issued a revised regulatory return for use by AIs in reporting their capital positions on the basis of the new capital requirements introduced by the BCAR 2012. AIs started reporting their capital positions as at the end of March 2013 using the revised return. Further updates to the completion instructions for the regulatory return were made in June to align with the technical changes introduced by the BCAR 2013.

Basel III (continued)

Participation in Basel III working groups

As a member of the Basel Committee, the HKMA has continued to participate in the Committee's work on the implementation of the Basel III framework. The HKMA is represented on the Committee's Working Groups on Liquidity, Capital and Disclosure and its Quantitative Impact Study Working Group, which have been tasked with addressing outstanding issues relevant to the application of the Basel III standards.

Basel III implementation monitoring process

Since 2011, the HKMA has been contributing data from selected Hong Kong-incorporated AIs for the Basel Committee's quantitative impact study (QIS) to facilitate assessment of the impact of the Basel III capital and liquidity requirements[4] and the monitoring of banks' progress in implementation.

The HKMA also carried out a similar QIS locally on liquidity covering a broader sample of AIs. Based on the results to date, AIs in Hong Kong are generally not expected to encounter major difficulties in complying with the new liquidity standards over the transition period, although some may need to adjust their liquidity profile or liquid asset composition. The information collected in the QIS has enabled the HKMA to better assess the effects of the liquidity standards on different types of AIs (such as those that are incorporated outside Hong Kong, wholesale-oriented in their business, or predominantly retail-based) and inform the HKMA's policy decisions on implementing the liquidity standards in Hong Kong.

[4] In the case of capital requirements, the impact is assessed based on a fully implemented basis, for example, including capital buffers and higher loss absorbency capital surcharge for systemically important financial institutions.

Improving Supervisory Policy Framework

Interim reporting requirements for over-the-counter (OTC) derivatives transactions

In line with the commitment of the G20 leaders to reform the OTC derivatives market globally, the HKMA has been working with the SFC and the FSTB to establish a regulatory regime for the local OTC derivatives market through amendments to the Securities and Futures Ordinance (SFO) to implement, among other things, mandatory reporting and clearing requirements.

In early 2013, the FSB indicated an expectation that member jurisdictions (including Hong Kong) should have trade reporting regulations in place by July 2013. As the new regulations under the SFO are not expected to take effect before mid-2014 and to meet the FSB's expectation, the HKMA issued a circular in June (following industry consultation) under section 63(2) of the Banking Ordinance, requiring all licensed banks (being the major players in the local OTC derivatives market) to report specified OTC derivatives transactions to the local trade repository operated by the HKMA until such time as the relevant legislation under the SFO comes into effect. The interim reporting arrangements, which represent a simplified version of the full-scope reporting to be implemented under the SFO, took effect from 5 August with a grace period of around six months for banks to achieve full compliance.

Other policy development work

Financial Sector Assessment Programme (FSAP)

The HKMA conducted a detailed self-assessment of its regulatory and supervisory framework against the Basel Committee's *Core Principles for Effective Banking Supervision* for the purpose of an update by the IMF of the FSAP assessment for Hong Kong (the last FSAP was undertaken in 2003). In addition to conducting the self-assessment, the HKMA held extensive meetings with the FSAP assessors to explain the legal and regulatory framework for banking supervision and how it is carried out. It also arranged for the assessors to meet government officials and the private sector (including banks, credit rating agencies and audit firms) to enable them to undertake a comprehensive review of the financial sector in Hong Kong. In collaboration with selected AIs, the HKMA and the FSAP assessors conducted a number of liquidity and solvency stress tests during the review, using scenarios and frameworks either adopted by the HKMA or proposed by the FSAP assessors. Overall, the preliminary assessment results were favourable. The HKMA will follow up on recommendations from the assessors and, where appropriate, amend relevant rules and supervisory guidance to close any regulatory gaps.

Accounting standards

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) have continued their work to improve and converge accounting standards. The development of high-quality, converged accounting standards for the classification and measurement of financial instruments and for loan-loss provisioning is of particular relevance to banks and banking supervisors. While progress has been made towards eliminating differences in the Boards' respective classification and measurement models, the two standard-setters have developed different expected-loss models for public consultation. In essence, the difference between their proposals is in the impairment accounting for performing loans. Given the importance of a single, globally applied, standard on accounting for loan-loss provisions that recognises credit losses earlier and more consistently, the banking regulatory community has been closely following developments in this area. In particular, following its Plenary meeting in November, the FSB publicly urged the IASB and the FASB to make further efforts towards convergence.

During the year, the HKMA maintained regular dialogue with the Banking Regulatory Liaison Group of the Hong Kong Institute of Certified Public Accountants (HKICPA) on topics of common interest. These included the latest developments in international accounting convergence, new accounting and financial reporting standards issued by the HKICPA and their implications for the banking industry, and key supervisory policy initiatives domestically and internationally, including those in relation to banks' external auditors.

Recovery and resolution

As part of its package of policy measures to reduce the risk posed by systemically important financial institutions, the FSB issued a set of *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes) in November 2011. All member jurisdictions of the FSB, including Hong Kong, are expected to meet these new international standards to ensure that both public authorities and financial institutions will be better placed to respond effectively to shocks that threaten to undermine the financial soundness of individual financial institutions, including financial market infrastructures.

The extent to which the existing arrangements for contingency planning and dealing with distressed firms meet the new standards in the Key Attributes has been assessed by the Hong Kong authorities and subsequently by the FSB in a thematic peer review. This work confirmed that although the statutory and regulatory framework in Hong Kong was relatively well-developed before the global financial crisis, some significant gaps exist in comparison to the requirements of the Key Attributes and these need to be addressed to reflect the latest best practices for effective resolution regimes. The HKMA worked with the FSTB, the SFC and the OCI during the year on a public consultation on proposals for legislative reform to address the identified gaps. The consultation was launched in January 2014.

The new standards in the Key Attributes also require the implementation of local recovery and resolution planning requirements for banks in Hong Kong. Following consultations with the industry, the HKMA developed a new SPM module on Recovery Planning, which is expected to be finalised in early 2014. The HKMA also participated in the crisis management groups for a number of G-SIBs where work is underway to develop firm-specific group-level recovery and resolution plans.

International co-operation

The HKMA continues to take part in a range of international and regional forums for banking supervisors. It is currently a member of the Basel Committee and its governing body, the Group of Governors and Heads of Supervision, and is represented on various Basel Committee working groups, including the Policy Development Group and the Supervision and Implementation Group. The HKMA is also a member of the sub-groups under the Policy Development Group, including the Capital Planning Group, the Large Exposures Group (which consulted during 2013 on a new international framework for measuring and controlling large exposures), the Quantitative Impact Study Working Group, the Task Force on Standardised Approaches (a new group established in 2013 to undertake a review of the Standardised Approach to the measurement of credit risk within the Basel framework and consider enhancements to ensure it remains robust and appropriately calibrated), the Task Force on Interest Rate Risk in the Banking Book (another new group established in 2013 to consider options for capturing interest rate risk in the banking book within the capital framework), the Working Group on Disclosure, the Working Group on Capital, and the Working Group on Liquidity. The HKMA also participates in the Basel Committee and IOSCO joint Working Group on Margining Requirements.

The HKMA is a member of the FSB Standing Committees on Supervisory and Regulatory Co-operation and on Assessment of Vulnerabilities. It also participates in a number of the FSB working groups including the Resolution Steering Group, the Cross-border Crisis Management Working Group, the Intensity and Effectiveness Group, the Compensation Monitoring Contact Group, and the Workstream on Other Shadow Banking Entities.

Regionally, the HKMA is a member of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) and the South East Asia, New Zealand and Australia Forum of Banking Supervisors. As part of its work within the EMEAP Working Group on Banking Supervision, the HKMA is the Champion of the Interest Group on Liquidity (IGL). During the year, the IGL carried out two surveys on EMEAP jurisdictions' intended policies for implementing the Basel III liquidity standards, with the results discussed at the Working Group's meetings.

FSB Peer review of Germany

In the context of the FSB's peer review programme, the HKMA led the international expert team that assessed the steps taken, or planned, by the German authorities to address recommendations from the IMF's FSAP and Reports on Observance of Standards and Codes relating to financial regulation and supervision, as well as to institutional and market infrastructure, that are deemed most important and relevant to the FSB's core mandate of promoting financial stability. Once approved by the FSB, the final report is expected to be published in April 2014.

Consumer protection

Code of Banking Practice

The industry's overall compliance with the Code of Banking Practice remained satisfactory. In the industry's self-assessment covering the period from 1 January to 31 December 2012, all AIs reported full, or almost full, compliance[5]. The non-compliance issues reported mostly concerned transparency and disclosure of information and the related policies and procedures. The AIs concerned have taken active steps to address the issues. The HKMA also conducted thematic examinations of three AIs to review their compliance with the Code and related policies and controls. The Code of Banking Practice Committee, on which the HKMA is represented, conducted a review of the Code to further enhance practices. The Committee discussed and agreed on amendments to strengthen the disclosure and transparency of banking services and promote good banking practices, offering better protection to financial consumers. The amendments are expected to be introduced in 2014.

G20 High-level Principles on Financial Consumer Protection

The HKMA continued to participate in the Task Force on Financial Consumer Protection of the Organisation for Economic Co-operation and Development (OECD) to develop effective approaches to support the implementation of the *G20 High-level Principles on Financial Consumer Protection*. The effective approaches for three of the 10 Principles, which were identified as higher-priority principles, were endorsed at the G20 Summit in September.

[5] With seven or fewer instances of non-compliance.

Treat Customers Fairly Charter

The Treat Customers Fairly Charter, a joint initiative of the HKMA and the banking industry, aims to foster a stronger culture of fair treatment of customers at all levels within banks and at all stages of their relationship with customers. The Charter, comprising five high-level principles, draws on good practices locally and overseas and the *G20 High-level Principles on Financial Consumer Protection*. At a launching ceremony hosted by the HKMA on 28 October, all 22 retail banks in Hong Kong signed up to the Charter.

Chief Executive of the HKMA, Mr Norman Chan, gives his opening remarks at the Treat Customers Fairly Charter launching ceremony. Twenty-two retail banks in Hong Kong have signed up to the Charter, pledging to provide better and stronger protection to bank customers in Hong Kong.

To promote the Charter's principles, the HKMA has also discussed with the banks the possibility of abolishing dormant account fees and waiving low-balance fees for vulnerable groups and the provision of basic banking services. In response, all retail banks which previously charged dormant account fees have abolished such fees. All banks that charge low-balance fees waive the fee for vulnerable customers. They will also adopt a flexible approach in relation to the charging of low-balance fees for low-income customers, either treating them as vulnerable customers and waiving the low-balance fee, or providing them with unlimited or limited free access to branch counter services in relation to their use of basic bank accounts which do not have a minimum balance requirement.

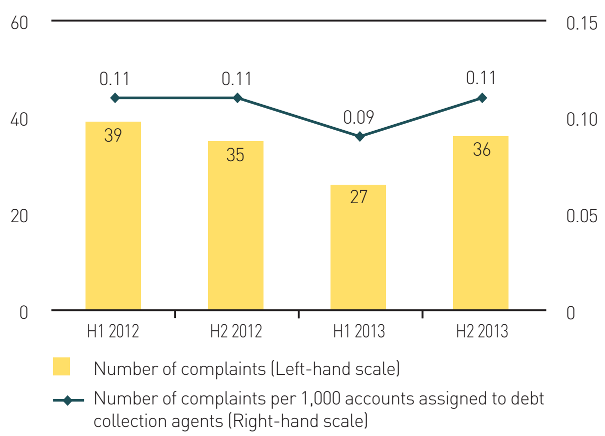
Credit data sharing

At the end of 2013, 118 AIs and subsidiaries of AIs were sharing commercial credit data through the Commercial Credit Reference Agency (CCRA). The scheme contained the credit data of more than 129,000 business enterprises, about 18% of which were sole proprietorships and partnerships. On the sharing of consumer credit data, the HKMA conducted two on-site examinations to review AIs' compliance with the regulatory requirements on the positive mortgage data sharing scheme and related policies and controls. Some issues and areas for improvement were identified. The AIs concerned have been asked to take appropriate actions to address those issues.

Customer complaints relating to debt collection agents employed by AIs

The number of complaints received by AIs about their debt collection agents decreased to 63 from 74 in 2012 (Chart 1). The HKMA will continue to ensure that AIs properly monitor the conduct of their debt collection agents.

Chart 1 **Complaints received by AIs about their debt collection agents**



Consumer education

The HKMA launched a consumer education programme encouraging the public to be "smart and responsible" in the use of banking services. The programme started with radio broadcasts with smart tips on using ATMs and internet banking through computers and smartphones, and on spending with credit cards. Feature articles and illustrations also appeared in the print media to disseminate such tips. The HKMA worked with the IEC to organise a creative competition to educate young adults on money management and financial planning. Seminars for senior secondary school students were also held at community halls to promote responsible spending. A designated webpage with the icon "Consumer Education Programme" was developed on the HKMA website to facilitate public access to programme materials.

Enforcement

Banking complaints

The HKMA resolved the bulk of the backlog of complaints which had built up in recent years because of the earlier need to give priority to resolving Lehman Brothers-related cases. By the end of the year, the total number of outstanding cases had been reduced from 1,313 to 500 (Table 3). Handling of new complaints on banking services was expedited, with most being resolved within three months of being received.

The number of complaints received regarding mis-selling of investment products declined by about half (to 59) for the year. However, the number of complaints relating to insurance products increased by 39 cases (to a total of 93), ILAS by 12 cases (to 44) and credit card fees and charges by 37 (to 62). These areas will be a focus of attention in 2014.

Feature articles and illustrations in the print media

Table 3 Banking complaints received by the HKMA

	2013			2012
	Conduct - related issues	**General banking services**	**Total**	Total
In progress on 1 January[Note]	675	638	**1,313**	1,927
Received during the year	237	878	**1,115**	916
Completed during the year	(620)	(1,308)	**(1,928)**	(1,530)
In progress on 31 December	292	208	**500**	1,313

Note: The related figures have been adjusted after reclassification of certain complaints.

Enforcement actions

In June, the HKMA suspended the registration of a current relevant individual (Rel) for three years under the Banking Ordinance, following an investigation which found that the Rel was not a fit and proper person in relation to the sale of an ILAS product to a customer in October 2010. In July, the HKMA and the SFC reached an agreement with The Royal Bank of Scotland N.V. (RBS), formerly known as ABN AMRO Bank N.V., pursuant to section 201 of the SFO with respect to the sale of Lehman Brothers-related equity-linked notes. Under the agreement, RBS agreed to make a repurchase offer to eligible retail investors in the equity-linked notes. In December, the offer was extended to eligible professional investors by a further agreement between the HKMA, the SFC and RBS.

During the year, disciplinary sanctions, ranging from suspension to a life ban, were imposed by the SFC on eight former Rels following referral by the HKMA.

Banking complaints-handling and enforcement processes review

The HKMA commissioned an external consultant to undertake an independent review of its complaints-handling and enforcement processes with the aim of making them more effective. The review was completed in January 2014 and made a number of recommendations relating to the framework, structure and people, processes and controls, reporting and documentation. The recommendations are being considered by the HKMA.

Deposit Protection Scheme

The Deposit Protection Scheme (DPS) continued to offer protection to deposits up to $500,000 per depositor per bank. Based on the results of a self-assessment conducted in 2012 against the *Core Principles for Effective Deposit Insurance Systems* jointly issued by the Basel Committee and the International Association of Deposit Insurers, a more focused review was conducted to study and evaluate ways to make the DPS more efficient and effective, including improvements to its infrastructure and capacity, as well as mechanisms to handle a payout in the event of a bank failure.

Following the self-assessment, a two-year payout reform plan was developed to improve payout efficiency. Amendments were made to the Information System Guideline to improve the availability and quality of information to be provided by DPS member banks (Scheme members) to facilitate prompt compensation payments to depositors in 2013. An early warning system was also established between the HKMA and the Hong Kong Deposit Protection Board to facilitate timely notification to the deposit insurer of a possible bank failure when specified indicators are met. The advance notification will allow early preparation to speed up any eventual payout.

In 2013, the FSAP led by the IMF completed a review of the crisis management and bank resolution framework in Hong Kong, including the functioning of the DPS in contributing to financial stability in Hong Kong.

To monitor compliance with the DPS Representation Rules by Scheme members, the system of annual self-assessments by Scheme members and on-site examinations by the HKMA was maintained. The results were satisfactory and no significant issues of non-compliance were identified.

Emphasis continued to be placed on the coverage and effectiveness of DPS publicity and community education activities. The publicity campaigns undertaken during 2013 sustained the general awareness of the DPS at 77%. Given this high level of general awareness, more effort was devoted to community education and outreach programmes aimed at specific groups, such as senior citizens, housewives and young people.

Oversight of financial market infrastructures

During the year, the HKMA issued a policy statement setting out its approach to oversight of the financial market infrastructures (FMIs) under its purview. The policy objectives of the HKMA in overseeing these FMIs are to promote their general safety and efficiency, to limit systemic risk and to foster transparency. The aim is to make the FMIs more resilient to financial crises and to protect the monetary and financial systems in Hong Kong from possible destabilising effects arising from disruption to the FMIs.

The Clearing and Settlement Systems Ordinance (CSSO), which was enacted in 2004, empowers the Monetary Authority to designate and oversee clearing and settlement systems that are material to the monetary or financial stability of Hong Kong, or to the functioning of Hong Kong as an international financial centre. Its purpose is to promote the general safety and efficiency of the designated systems: the Central Moneymarkets Unit (CMU), Hong Kong dollar Clearing House Automated Transfer System (HKD CHATS), US dollar CHATS, Euro CHATS, Renminbi CHATS and the Continuous Linked Settlement (CLS) System. The reporting service of the OTC Derivatives Trade Repository of the HKMA (HKTR) was launched in July 2013. The HKTR is owned and operated by the HKMA. Since it is not a clearing or settlement system, it is not a designated system under the CSSO. The HKMA published a new oversight framework and commenced oversight of the HKTR in July 2013. However, it is the policy intention of the HKMA to oversee the HKTR in the same way and apply, where relevant, the same standards, as the other FMIs under its purview.

The Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements and the Technical Committee of the IOSCO published the *Principles for Financial Market Infrastructures* (PFMI) in 2012. The PFMI constitutes the latest international standards on the oversight of the FMIs including systemically important payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories. In Hong Kong, the HKMA and SFC jointly issued a policy statement in March on the adoption of the PFMI for the systematically important FMIs in Hong Kong. To implement the requirements under the PFMI, the HKMA issued, also in March, an amended statutory guideline, "Guideline on the Oversight Framework for Designated Systems" under the CSSO, and published a new guideline in July on the oversight of the HKTR, the "Guideline on the Oversight Framework for the Hong Kong Trade Repository".

Except for the CLS System, the HKMA oversees other FMIs under its oversight through off-site reviews, continuous monitoring, on-site examinations and meetings with management. All the FMIs continued to comply with the relevant requirements.

During the year, the HKMA worked extensively with FMIs under its purview to ensure observance of the PFMI, including requesting them to conduct self-assessments, which it then reviewed. The HKMA considers the FMIs generally observe the relevant PFMI principles, although further work is required in specific areas where the principles strengthen risk management requirements and broaden the scope of applicability.

International participation

The HKMA continues to participate in the meetings and forums on FMI oversight matters. It is a member of the CPSS and attended meetings of the main committee and its working groups on topics relevant to FMI oversight. The HKMA also participated in a task force established by the CPSS and the IOSCO responsible for monitoring and assessing the implementation of the PFMI by different jurisdictions. The Level 1 assessment, which reviewed whether jurisdictions had completed the process of adopting legislation and policies implementing the PFMI, revealed the HKMA had adopted the PFMI within its oversight framework.

The HKMA is a member of the SWIFT Oversight Forum. SWIFT is a major global message carrier for financial institutions and market infrastructures. The Forum, chaired by the National Bank of Belgium and comprising member economies that are major users of SWIFT's services, discusses SWIFT oversight matters and shares SWIFT-related information. The HKMA has an interest in SWIFT's operations because AIs and FMIs in Hong Kong use, and rely on, its services and may be exposed to risks in the event of any disruption to its operations. The HKMA attended meetings held by the Forum and during the year, it also participated in a task force, established under the Forum, on the development of the assessment methodology for Annex F of the PFMI, which applies to critical service providers.

The HKMA also participates in the international co-operative oversight of the CLS System through the CLS Oversight Committee. The CLS System is a global clearing and settlement system operated by the CLS Bank for cross-border foreign exchange transactions. It enables foreign exchange transactions involving the CLS eligible currencies, including the Hong Kong dollar, to be settled on a payment-versus-payment (PvP) basis. During the year, the HKMA attended various meetings and teleconferences of the CLS Oversight Committee to discuss matters concerning the operations and developments of the CLS System, as well as Hong Kong dollar-specific matters to ensure the System continued to meet the safety and efficiency requirements under the CSSO.

In addition to the CLS System, the HKMA also discussed with relevant overseas authorities to further strengthen the co-operative oversight of links established between the FMIs in Hong Kong and those overseas. Such arrangements exist for the US dollar/Malaysian ringgit PvP link and the US dollar/Indonesian rupiah PvP link.

Independent tribunal and committee

An independent Clearing and Settlement Systems Appeals Tribunal was established in 2004 to hear appeals against decisions of the Monetary Authority on designation and related matters under the CSSO. There has been no appeal since the establishment of the Tribunal.

An independent Process Review Committee, whose members are appointed by the Chief Executive of the Hong Kong Special Administrative Region, reviews processes and procedures adopted by the HKMA in applying standards set under the CSSO to systems in which the HKMA has a legal or beneficial interest. The Committee assesses whether the HKMA has applied the same procedures to all designated systems. The Committee met twice in 2013 and reviewed four regular reports and 22 accompanying oversight activities management reports. The Committee concluded that it was not aware of any case where the HKMA had not duly followed the internal operational procedures, or where the HKMA had not been procedurally fair in carrying out its oversight activities. Under its terms of reference, the Committee submitted its annual report to the Financial Secretary, which is available on the HKMA website.

Informal oversight of retail payment systems

The HKMA encourages the retail payment industry to adopt a self-regulatory approach by issuing codes of practice to promote the safety and efficiency of retail payment systems.

The HKMA monitors the compliance of Octopus Cards Limited (OCL) with the Code of Practice for Multi-purpose Stored Value Card Operation issued by OCL and endorsed by the HKMA in 2005. In 2013, OCL completed its annual self-assessment against the Code and reported its full compliance.

The Code of Practice for Payment Card Scheme Operators, issued by eight credit and debit card scheme operators and endorsed by the HKMA in 2006, sets out principles covering operational reliability, data and network security, and the efficiency and transparency of payment card operations in Hong Kong. The HKMA monitors the operators' compliance with the Code and operators are required to perform an annual self-assessment and report to the HKMA any incident which may have material and adverse impact on Hong Kong cardholders. In the annual self-assessment report covering activities in 2013, the eight card scheme operators reported full compliance with the Code. Since June 2010, the HKMA has published quarterly aggregate payment card data collected from the card operators to promote transparency of the payment card industry.

Licensing

At the end of 2013, Hong Kong had 156 licensed banks, 21 restricted licence banks, 24 deposit-taking companies and 15 approved money brokers. During the year, the HKMA granted two bank licences to two foreign banks and approved one money broker incorporated outside Hong Kong. One licensed bank revoked its authorization during the year.

The HKMA issued a circular on skills and knowledge development for directors of locally incorporated AIs in August 2013. The circular informed AIs of the broad results of a survey in 2012 on the training and development activities made available to directors and observations from meetings with candidates for director, chief executive and alternate chief executive appointments since August 2012. The circular also set out the approach the HKMA will take to enhance the knowledge and skills of directors, chief executives and alternate chief executives and announced the formation of an advisory group, led by the HKMA, with members drawn from the HKIB and persons with strong experience in the industry to advise on skills and knowledge development for directors.

The HKMA sees advantages in the provision of programmes to the industry to support skills and knowledge development for directors of AIs. In 2013, the HKMA worked with the HKIB to develop induction and continuing programmes for directors. In September and October, the HKIB organised a two-module Corporate Governance programme, aimed at the introductory level for recently appointed directors of AIs. The programme had solid response with over 100 participants attending at least one of the modules.

Supervision of parent companies of banks

In October 2013, the HKMA elaborated its policy on applications to hold more than 50% of the share capital of AIs incorporated in Hong Kong from persons who are neither banks nor supervised financial institutions. In considering such applications, the HKMA's primary concern will be to ensure that any risks that may be posed to the existing or proposed AI by the applicant, and any other members of the corporate group of which the applicant is a member, are understood and well contained. To achieve this, the HKMA may impose conditions on the applicant, who will generally be asked to establish a holding company incorporated in Hong Kong, whose sole purpose will be to hold the existing or proposed locally incorporated AI (it may conduct other business or activities if they are for the purposes of providing support to the business or activities of the existing or proposed AI). This immediate holding company will itself be subject to certain conditions, in addition to those imposed on the applicant and its ultimate holding company (if applicable). The conditions to be imposed will cover, among other things, requirements on capital adequacy, liquidity, large exposures, intra-group exposures and charge over assets, group structure, activities undertaken, risk management, fitness and propriety of directors and senior management and the submission of financial and other information to the Monetary Authority.

PLANS FOR 2014 AND BEYOND

Supervisory focus

Risk governance

Recognising the importance of a strong risk culture within AIs to the safety and soundness of the banking sector, the HKMA will focus on the risk governance of AIs and continue its efforts to strengthen communication with the risk management functions, as well as the boards or board-level committees of locally incorporated retail banks.

Credit growth

In the light of uncertain global economic conditions and heightened concerns about market volatility, the HKMA will continue to take proactive steps to ensure Hong Kong's banking system is resilient to a possible reversal of the credit cycle, and that the banking sector can perform a stable and sustainable credit intermediation function.

Mainland-related business

AIs' Mainland-related business will remain an important supervisory focus. The HKMA will continue with its established supervisory approach with a heightened emphasis on prudence underpinned by proactive and forward-looking supervision. The HKMA will conduct on-site examinations and off-site analyses of corporate-sector lending, focusing on non-bank Mainland exposures and potential Mainland-related risks.

Supervision of liquidity risk

The HKMA will continue to enhance AIs' liquidity planning and management in anticipation of fund outflows. In line with this, more in-depth liquidity stress tests will be conducted to ascertain the impact of fund flows on the banking system in Hong Kong. The HKMA will continue to closely monitor the interest rate trend and its impact on the banking sector.

Prevention of money laundering and terrorist financing

A new division will be established within the Banking Supervision Department to further strengthen and consolidate the resources available for AML/CFT supervision, allowing an increased number of on-site examinations and desktop reviews and a more proactive approach in mitigating emerging money-laundering and terrorist-financing risks. The HKMA will continue to work with the FSTB, other financial regulators and the industry to keep Hong Kong's AML/CFT regime under review and will develop further guidance on relevant controls.

Active participation by the HKMA in various international AML forums (such as the Financial Action Task Force) will continue in order to ensure Hong Kong's risk-based approach to AML supervision is consistent with international practice and allows more effective use of resources to address areas of higher risk.

Supervision of operational and technology risks

The HKMA's operational and technology specialist teams will be integrated to make supervising AIs' operational and technology risks more effective. To allow early detection of emerging operational risks, the HKMA will increase its supervisory resources and step up monitoring of potential operational events arising from market changes and other external factors. Apart from ongoing supervisory activities such as on-site examinations, off-site reviews and independent compliance assessments, the HKMA will conduct more thematic and business-focused reviews to ensure AIs have adequate systems and controls to manage operational risks. Separately, the HKMA is working with the e-Banking Security Committee of the Hong Kong Association of Banks (HKAB) to update the SPM on the "Supervision of E-banking" with a view to taking into account the latest technology and market developments.

Supervision of securities, investment products, insurance and MPF-related businesses

The HKMA will:

- continue to work closely with the SFC and the banking industry to provide further guidance on the standards the HKMA expects institutions to observe in the sale of investment products

- continue to provide advice and assistance to the private wealth management industry, the HKIB, HKSI and TMA in finalising and launching the ECF

- share with the industry and other regulators industry-wide issues and good practices identified in the mystery shopping programme to enhance AIs' compliance culture, sales practices and internal controls

- continue to work with the OCI and the banking industry on enhancing AIs' practices in selling insurance products

- continue to co-operate with the FSTB and the OCI in the legislative process for a statutory regime for establishing an independent Insurance Authority

- continue off-site and on-site surveillance of AIs' conduct in selling securities, MPF and other investment and insurance products, including strengthened risk-based supervision of the sale of investment products to private banking customers with the newly launched half-yearly survey.

Supervision of treasury activities

The HKMA will continue to conduct on-site examinations of AIs' treasury and derivative activities, follow up with selected AIs on weaknesses identified through thematic examinations on liquidity risk management, and expand compliance checks to more AIs based on risk-materiality assessments. Supervisory resources will be deployed to areas of concern, such as assessment of AIs' treasury position booking practices.

Supervisor-driven stress testing programme

The HKMA will further develop and enhance the supervisor-driven stress testing programme as one of the tools for supervising the capital management of AIs. The improvements will bring the programme more into line with international standards and latest developments through, among other things, making AIs' stress testing more robust and consistent, and scrutinising and validating AIs' submissions through a combination of on-site examinations and off-site reviews of their assumptions, methodologies and results. The HKMA will ensure a closer link between AIs' stress test results and their capital requirements.

Co-operation with overseas supervisors

A key item on the HKMA's supervisory agenda will be to work with the crisis management groups of international banks on formulating recovery and resolution plans in accordance with the timetable set by the FSB. Efforts will be made by the HKMA to ensure the timely sharing of bank-specific prudential and other matters, including the latest developments on liquidity and solvency positions with overseas supervisors. With the creation of the Single Supervisory Mechanism in Europe later in 2014, the HKMA looks forward to developing a close working relationship with the new European supervisory body.

Basel III

Capital standards

Under the Basel Committee's transition timetable, regulations for the implementation of the second phase of the Basel III capital standards (the capital conservation buffer, the countercyclical capital buffer and, for banks identified as G-SIBs or D-SIBs, the higher loss absorbency requirements) are required to be in place from 1 January 2015. This will allow banks one year to adjust their capital planning to meet the new requirements as they are phased in from the beginning of 2016. The HKMA expects to consult the industry during 2014 on the proposed amendments to the Banking (Capital) Rules to implement the new standards, with the aim of tabling the amendments before the LegCo for negative vetting in the fourth quarter, and the proposed guidance (in the form of SPM modules) to establish the framework for, and set out key aspects of, the operation of the new standards.

Where necessary, the HKMA will develop and issue further supplementary guidance to facilitate consistent interpretation and application of the Banking (Capital) Rules.

Disclosure standards

Under the Basel Committee's transition timetable, banks will be required to make disclosures in relation to the Basel III leverage ratio from 1 January 2015. The HKMA will introduce amendments to the Banking (Disclosure) Rules during 2014 to give effect to these disclosure requirements. Other amendments proposed to be introduced at the same time include those corresponding to the second phase of the Basel III capital standards (that is, disclosures in relation to the holding by AIs of regulatory capital for the purpose of meeting the capital buffers and, for those AIs designated as G-SIBs or D-SIBs, the higher loss absorbency capital requirements applicable to them). The introduction of amendments relating to the disclosure of the Basel III LCR standard and the modified Liquidity Ratio will follow, having regard to the LCR disclosure requirements and implementation timetable to be finalised by the Basel Committee in 2014. Where necessary, the HKMA will issue standard disclosure templates in line with the Basel Committee requirements to facilitate consistency and comparability of disclosures among banks and across jurisdictions.

Supplementary guidance for Basel III implementation

An updated SPM module on "Overview of Capital Adequacy Regime for Locally Incorporated Authorized Institutions", reflecting the legislative changes for Basel III implementation, is expected to be issued for industry consultation in 2014. The HKMA will also consider the necessary updates to its existing SPM module on "Guideline on the application of the Banking (Disclosure) Rules" to cover the additional disclosure requirements brought about so far by Basel III implementation.

Basel Committee Regulatory Consistency Assessment Programme

To facilitate and encourage full and consistent implementation of the Basel capital framework, the Basel Committee adopted a Regulatory Consistency Assessment Programme (RCAP) in 2012 to assess the consistency of its member jurisdictions' regulatory capital frameworks with the Basel II, Basel 2.5 and

Basel III (continued)

Basel III standards. The Basel Committee has so far published the results of its RCAP assessments of the US, the European Union, Singapore, Switzerland, Japan, the Mainland, Brazil and Australia. The RCAP assessment on Hong Kong is scheduled to commence in 2014. The HKMA will complete a detailed self-assessment of the prevailing law and rules in Hong Kong against the Basel standards and will work with the RCAP assessment team to facilitate its review and to follow up on any issues that the team may identify.

Liquidity standards

The HKMA will develop a set of Banking (Liquidity) Rules (BLR) to prescribe the liquidity requirements applicable to AIs subject to the LCR and to those that are to observe the modified Liquidity Ratio. The intention is to table the BLR in the LegCo later in 2014 after completing the requisite statutory consultation.

The HKMA will augment the existing liquidity reporting framework to support the reporting by AIs of information in relation to their LCR or modified Liquidity Ratio, and in relation to the Basel liquidity monitoring metrics, where appropriate, to enhance supervision of their liquidity risk profiles and positions. The industry will be consulted on the revised liquidity returns during 2014. The HKMA will also seek to expand the scope and frequency of the local implementation monitoring process, by covering (in addition to the LCR) the reporting of the modified Liquidity Ratio and increasing the reporting frequency from semi-annual to quarterly (and ultimately to monthly) in the second half of 2014. This will give AIs more opportunity to test their reporting systems for the new liquidity reporting framework.

In developing the BLR and the liquidity reporting framework, the HKMA will maintain its dialogue with the industry and take account of the implementation approaches adopted by major overseas regulators.

The implementation of the new liquidity standards and accompanying reporting framework will necessitate consequential changes to the existing statutory guideline "Liquidity Risk Management" in the SPM. The approach to supervising AIs' management of their liquidity risk will also be updated under the enhanced liquidity regime.

In addition, the HKMA will make appropriate changes to the existing supervisory guideline "Supervisory Review Process" in the SPM to ensure that the assessment of liquidity risk under the Supervisory Review Process accords with the revised liquidity standards and risk management requirements.

SIFI framework

The higher loss absorbency capital requirements for institutions designated as G-SIBs and D-SIBs are scheduled to be phased in from 2016. The HKMA began consulting the industry in March 2014 on policy proposals for a framework to identify D-SIBs in Hong Kong and assess the required level of higher loss absorbency to be applied to them. The framework has been developed by reference to the principles drawn up by the Basel Committee in its "framework for dealing with domestic systemically important banks". In addition to a mechanism for identifying them in Hong Kong and applying higher loss absorbency requirements to them, the local D-SIB framework is also proposed to cover more intensive supervision of, and recovery and resolution planning for, D-SIBs. The HKMA expects to finalise the framework in 2014 with the aim of designating local D-SIBs no later than 1 January 2015 to allow the higher loss absorbency capital requirements to be phased in from 1 January 2016.

While no locally incorporated AIs are currently designated as G-SIBs, the HKMA intends to make provision in the Banking (Capital) Rules empowering the Monetary Authority to designate locally incorporated AIs as G-SIBs, to cover the eventuality of a local banking group meeting the criteria in future. The HKMA also plans to issue guidance to support the implementation of the G-SIB framework in Hong Kong.

Recovery and resolution

During 2014, the HKMA will continue to work with the FSTB, the SFC and the OCI to refine the proposals for the establishment of an effective resolution regime for financial institutions in Hong Kong in accordance with the Key Attributes promulgated by the FSB. An initial three-month public consultation exercise was launched in January 2014 proposing:

- a common framework for resolution, with a single resolution regime under which a designated public authority would be able to intervene to take swift and decisive action to bring about the orderly resolution of a failing financial institution (including financial market infrastructures) within the scope of the regime, in order to secure continuity of critical financial services and protect wider financial stability

- a menu of resolution options as alternatives to insolvency which, where the necessary conditions are met, allow for the compulsory transfer of a failing financial institution, or some or all of its business, to a third party able to continue the provision of critical financial services and the imposition of a "bail-in" of creditors to quickly recapitalise and restore the viability of the failing firm

- robust governance arrangements for the regime as well as safeguards to protect parties who may otherwise be adversely affected by resolution, including safeguards to ensure that no creditor will be worse off than would have been the case in liquidation

- use of the local regime to support group-wide resolutions of cross-border financial services groups being carried out by authorities in their home jurisdictions, where it is assessed that resolution would be consistent with the objectives set for resolution in Hong Kong and would not otherwise disadvantage local creditors.

In relation to local recovery and resolution planning, it is expected that an initial wave of AIs will be required to begin preparing recovery plans in 2014 following the issuance of the new SPM module on Recovery Planning. Work will also begin on a separate complementary SPM module on Resolution Planning. The HKMA will continue to contribute to the group-level recovery and resolution planning being carried out for those G-SIBs with significant operations in Hong Kong.

Development of Supervisory Policies

Credit risk transfer

A supervisory guideline on credit risk transfer is being developed. The guidance will reflect recent international developments in the regulation of securitisation (such as disclosure requirements and measures to align incentives between originators and investors) and the reduction of reliance on the ratings produced by credit rating agencies (such as more stringent requirements for banks' internal credit assessment of securitisation exposures).

Counterparty credit risk management

The supervisory guideline "Counterparty Credit Risk Management" will be updated to bring it into line with the amendments made to the Banking (Capital) Rules for the purposes of Basel III implementation (including, in particular, the introduction of an internal models calculation approach for CCR) under the BCAR 2012, and to reflect other developments in counterparty risk management practices following the global financial crisis.

Monitoring tools for intraday liquidity management

In April 2013, the Basel Committee issued a paper on *Monitoring Tools for Intraday Liquidity Management*, which is designed to complement the qualitative guidance on intraday liquidity management set out in the *Principles for Sound Liquidity Risk Management and Supervision* issued by the Basel Committee in 2008. The HKMA intends to implement the guidance by January 2015, in line with the timetable set by the Basel Committee. The implementation proposals and reporting templates were issued in March 2014 for industry consultation.

Sound systems and controls for liquidity risk management

The HKMA intends to update, in 2014, the statutory guideline "Sound Systems and Controls for Liquidity Risk Management" (LM-2) in the SPM, having regard to the revisions to the LCR made by the Basel Committee in January 2013, international developments on liquidity risk management standards, and the experience gained to date in implementing LM-2. This reflects the HKMA's policy of placing a strong emphasis on the development of prudent risk management systems by AIs to enhance their liquidity resilience and their compliance with LM-2 requirements.

Internal audit and compliance functions

The HKMA will consult the industry on revisions to the supervisory guideline "Internal Audit Function" in the SPM to reflect the latest guidance on "The Internal Audit Function in Banks" issued by the Basel Committee in June 2012. Key areas of revision will relate to the approach to internal audit across banks within a banking group or holding company structure and the communication between supervisory authorities and banks' internal auditors. Consideration will also be given to developing a separate supervisory guideline to provide more detailed guidance on the attributes of an effective compliance function.

Development of Supervisory Policies (continued)

Large exposures and risk concentrations

Once the Basel Committee has finalised the enhanced large exposures regime, which was the subject of consultation in 2013, the HKMA will assess the policy implications for the local large exposures regime. Prior to introducing the new regime in Hong Kong, the HKMA may consider implementing some transitional changes to the reporting of counterparty credit risk exposures arising from foreign exchange, interest rate and other derivatives contracts in the Return of Large Exposures to facilitate more effective monitoring of AIs' large exposures.

Guideline on OTC derivatives market reforms

Once amendments to the SFO come into effect to establish the regulatory regime for the OTC derivatives market, and the relevant rules are issued under the SFO, the HKMA will issue supervisory guidance outlining the key requirements of the regime and its approach to supervising the OTC derivatives activities of AIs.

In September, the Basel Committee and the IOSCO published the final framework for margin requirements for non-centrally cleared derivatives for implementation from December 2015. The HKMA will further update the OTC derivatives regulatory regime in 2014 to implement the new global margining standards in Hong Kong.

External audits of banks

In March, the Basel Committee issued draft revised supervisory guidance on *External audits of banks* for public consultation. Drawing on lessons from the global financial crisis, the proposed guidance aims to improve the quality of external audits of banks by raising the bar to what supervisors expect of banks' external auditors and audit committees. Once the new guidance is finalised, the HKMA will consider the necessary updating of its prudential framework for AIs to reflect the new international standard on bank audit quality.

Other risk management guidance

In 2014, the HKMA will develop, and consult the industry on, new or revised guidance in other areas of risk management, to reflect the lessons of the global financial crisis, or better align with observed international best practices or guidance issued by the Basel Committee, including guidance relating to general risk management controls, market risk management and connected lending.

Accounting and disclosure standards

The HKMA will monitor developments in international accounting convergence, particularly in the area of loan-loss provisioning, and will maintain its dialogue with the HKICPA and the banking industry on these developments and their implications for the supervisory framework.

International co-operation

The HKMA will continue its active involvement in the work of the Basel Committee and the FSB, including through thematic peer reviews on trade reporting, SIFI supervision, and resolution regimes expected to be undertaken by the FSB in 2014.

Consumer protection

The HKMA will work with the industry's Code of Banking Practice Committee to finalise the revision of the Code with the aim of publishing a revised version within 2014. The HKMA will also monitor AIs' compliance with the Code through regular self-assessments, on-site examinations and the handling of complaints about products and services provided by AIs.

The HKMA will monitor how the industry adopts specific measures in 2014 to implement the Treat Customers Fairly principles.

Consumer education

In 2014, the HKMA will broaden the scope of its consumer education programme and launch further initiatives, including video productions, roving exhibitions and outreach activities, to enhance consumers' knowledge of banking services and help them develop a better understanding of their rights and obligations. In addition, the HKMA will continue to collaborate with other stakeholders (for example, the HKAB, the IEC and the Consumer Council) to maximise the benefits of consumer education.

Credit data sharing

The HKMA will continue to review AIs' implementation of the positive mortgage data sharing scheme through conducting on-site examinations of their compliance with the regulatory requirements and work with the industry to promote credit data sharing. Continued development of the credit data sharing arrangements will help strengthen the credit risk management capacity of AIs.

Enforcement

The HKMA will enhance its complaints-handling and enforcement processes taking into account the recommendations made by the consultant. Operational workflows will be revised to enhance productivity and effectiveness of the processes. A more structured programme of specialist training will be provided to staff in the Enforcement Department to enhance their skills and techniques in handling banking complaints.

The HKMA will closely monitor trends relating to complaints received and, where appropriate, take prompt action to contain or mitigate potential adverse consequences.

Deposit protection

The HKMA will continue to assist the Hong Kong Deposit Protection Board (HKDPB) in implementing and operating the DPS. In light of the latest overseas experience of reforms, options for making the handling of payouts more efficient and the DPS more sustainable are being researched and evaluated. A public consultation on the proposals is planned in 2014.

In accordance with the payout reform plan, the payout system, policies and procedures will continue to be revised to support the pre-payout preparatory arrangements and the tightened information submission timeline. To further streamline the payout process, payment channels other than paper cheques for disbursement of compensation will be explored. Self-assessments and on-site examinations will be conducted to monitor Scheme members' compliance with the representation requirements on DPS membership and protection status of financial products. Publicity efforts will mainly focus on maintaining the general level of awareness of the DPS and informing people who are not easily reached by conventional advertising media about the Scheme.

Oversight of financial market infrastructures

The HKMA will continue to promote the safety and efficiency of the FMIs under its oversight in accordance with the CSSO and the relevant international requirements, and monitor the performance of the operators of retail payment systems under their self-regulatory codes of practice.

The HKMA will work with the FMIs on their observance of the PFMI, including the preparation of the required disclosure framework for individual infrastructures. Assessments of the FMIs will be conducted, and the HKMA will continue participating in the CPSS/IOSCO PFMI implementation-monitoring and assessment exercise. Where appropriate, it will fine-tune its oversight requirements to reflect international practices or in response to developments.

Licensing

The HKMA will continue to work with the industry to encourage the provision of consistent and appropriate training and development programmes for directors of AIs. These activities may be at an introductory or intermediate level targeting both recently appointed and more experienced directors. Topics may range from general issues (focusing on the role and skills of directors, especially independent non-executive directors) to technical issues, covering areas of relevance to the banking sector which would be of particular benefit to directors.

To facilitate assessment of the quality of corporate governance of AIs for the purposes of the Supervisory Review Process, the HKMA, in its August 2013 circular on skills and knowledge development for directors of locally incorporated AIs, requires these AIs to submit a summary record of the training, development and other activities undertaken by each director (including chief executives and alternate chief executives), no later than one month after the end of each calendar year. The first submission is made by AIs at the end of January 2014. The HKMA will analyse these records and assess the extent and effectiveness of the activities provided to, and undertaken by, directors. The findings will help the HKMA identify and determine future initiatives on director development.