

# **Process Review Committee**

## **Annual Report to the Financial Secretary 2011-2012**

### **I. GENERAL INFORMATION**

#### **Background of establishment**

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

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

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

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

**Table 1:**

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

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

1.4 Of the six designated systems, the CLS system is the only one in which the HKMA does not have any interest. The CLS system is subject to the supervision of the U.S. Federal Reserve and is exempted under section 11 of the CSSO from the HKMA's oversight. The HKMA exercises ongoing oversight of the remaining five designated systems; the CMU, HKD CHATS, USD CHATS, EUR CHATS and RMB CHATS, and has an interest in all of them in one way or another. Some of these designated systems have established links with overseas payment or securities settlement systems to facilitate cross-border transactions, for example, the RENTAS<sup>1</sup> – USD CHATS payment-versus-payment (PvP) and delivery-versus-payment (DvP) links, and the BI-RTGS<sup>2</sup> – USD CHATS PvP link. Although these overseas systems are not overseen by the HKMA, the HKMA oversees these external links in coordination with the respective home overseers.

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

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

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

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

### **Scope of work and terms of reference**

1.6 The terms of reference of the PRC are:

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

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

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

### **Membership of the PRC**

1.9 The PRC is in its third term of service. Members of the PRC are appointed by the Chief Executive of the Hong Kong Special Administrative Region in their personal capacity for a three-year term from 1 December 2010 to 30 November 2013. The membership of the PRC as at 30 November 2012 was:

#### Chairman

**Prof Andrew Chan Chi Fai, SBS, JP**

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

#### Members

**Mr Chan Kay Cheung**

Vice-Chairman  
Bank of East Asia (China) Limited

**Prof Stella Cho Lung Pui Lan**

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

**Mr Nicholas Peter Etches**

Certified Public Accountant

**Mr Mervyn Robert John Jacob**

Financial Services Leader, Hong Kong and China  
PricewaterhouseCoopers

Ms Judy Wong Sau Pik

Partner, Assurance

Ernst & Young

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

2.1 This is the eighth Annual Report of the PRC, which covers the work of the Committee from 1 December 2011 to 30 November 2012. This is also the second annual report for the current PRC.

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

2.2 The PRC held two meetings in 2012. At the first meeting in July, Members reviewed the regular report covering the oversight activities of the HKMA from December 2011 to March 2012. In particular, Members discussed how the HKMA handled the abnormal events encountered by the designated systems.

2.3 Apart from this, Members were briefed on (i) a series of outages of the PvP link of the USD CHATS with Indonesia that occurred on four business days in May 2012 due to problems from the Indonesian side, (ii) the extension of operating hours of the RMB CHATS from 08:30-18:30 to 08:30-23:30 from 25 June to strengthen Hong Kong's capability in settling overseas RMB payments and Hong Kong's profile as an international offshore RMB clearing centre, and (iii) the work of the HKMA with the SOs/SIs of the local designated systems to achieve compliance with a new set of international standards, known as the Principles for Financial Market Infrastructures (PFMIs), published by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) in April. The PFMIs cover various aspects including the legal basis and governance of FMIs, credit and liquidity risk management, default management, general business and operational risk management, and transparency. Members noted that the HKMA would apply the same oversight standards to the local designated systems when implementing the PFMIs.

2.4 At the second meeting held in November, Members reviewed the regular report covering the period from July to September 2012. They also commented on the drafting of the Committee's eighth annual report to be submitted to the Financial Secretary. Members were updated on the actions to be taken to achieve compliance with the PFMIs, including revision of the oversight guideline by the Payment Systems

Oversight (PSO) team of the HKMA and that the designated systems would be required to conduct self-assessments against the PFMI in 2013. CPSS was discussing applications of the PFMI to FMI that are owned and operated by central banks. The PSO team would brief Members on the outcome of the discussion and would consider the application of PFMI to the HKMA-operated FMI (including HKD CHATS and CMU) with regard to the need to ensure a level playing field as far as possible.

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

2.6 Four regular reports were circulated to Members for review in 2012. Members noted that the HKMA met the performance benchmarks for oversight activities.

**Comments and recommendations of the PRC**

2.7 The format of the regular report and the accompanying oversight activities management reports were designed based on suggestions from Members. During the year, Members reviewed four regular reports and 21 accompanying oversight activities management reports covering the period from December 2011 to November 2012. Statistics showing the oversight activities contained in each regular report under the review of the PRC are summarised below:

**Table 2: Oversight activities of HKMA under the review of PRC from Dec 2011 to Nov 2012**

<b>HKMA’s oversight activities conducted during the quarter</b>	<b>1<sup>st</sup> Regular Report (Dec- Mar)</b>	<b>2<sup>nd</sup> Regular Report (Apr-Jun)</b>	<b>3<sup>rd</sup> Regular Report (Jul-Sep)</b>	<b>4<sup>th</sup> Regular Report (Oct-Nov)</b>
Processing of monthly return	36	27	27	18

submitted by SO/SI				
Vetting of changes in particulars of SO/SI	8	9	5	2
Reviewing of ad-hoc information submitted by SO/SI	46	36	39	34
Granting approval to changes in operating rules	6	15	5	13
Conducting on-site examinations	0	0	0	0
Handling of abnormal events/production incidents	7	3	7	6
Handling of contravention cases	0	0	0	0
Holding of meetings with management of SO/SI	4	0	0	0

2.8 At the meeting in July, Members discussed the handling of a number of abnormal events related to the PvP link of the USD CHATS with Indonesia's system. The payment systems oversight team of the HKMA held a teleconference on June 1 with Bank Indonesia (BI)'s operation and oversight teams to review the series of outages, which was due to problems with the Indonesian side, and discuss the remedial actions taken. It was noted that BI had implemented system and operation enhancements to address the problems as far as practicable. Drawing on the experience of the link, Members noted that it was important for the SOs/SIs to thoroughly study the system architecture of the relevant external systems and ensure adequate training for and good communications with the relevant external parties before launching any new external linkages in the future.

2.9 At the meeting in November, Members noted that the HKMA was developing a proposed legislative framework for the implementation of: i) a licensing regime for regulating stored value facilities; and ii) a designation regime for retail payment systems in Hong Kong through making amendments to the CSSO. The PSO team would keep Members informed of the development, given that PRC would have an interest in the proposed designation regime for retail payment systems.

2.10 A draft of the annual report was discussed at the meeting in November 2012. Members had no comments on the draft. Members agreed to adopt the same publication approach as for the previous annual reports. The PRC would propose to the Financial Secretary that the annual report be published in its entirety and be posted on the website of the HKMA for wider dissemination to the public in the interests of promoting transparency and accountability.

### **III. CONCLUSION AND WAY FORWARD**

3.1 During the period, the PRC reviewed four regular reports and 21 accompanying oversight activity management reports covering the period from December 2011 to November 2012. No complaints were received from the SOs and SIs and no alleged contravention events were noted during the period. The review covered, among other things, submissions by the HKMA on its processing of 108 monthly returns and 24 cases of changes in particulars, granting approvals to 39 changes in operating rules, handling of 23 abnormal events and production incidents, reviewing of 155 submissions of ad-hoc information and holding of 4 meetings with the management of the SOs and the SIs.

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

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