

# **Process Review Committee**

## **Annual Report to the Financial Secretary 2013-2014**

### **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 The HKMA is the owner/operator of HKD CHATS and the CMU and has a 50% stake in Hong Kong Interbank Clearing Ltd. (HKICL), which is the system operator of the four CHATS systems and provides computer support to the CMU (The Hong Kong Association of Banks (HKAB) holds the other 50% of shares in HKICL). Of the six designated systems, the CLS system is therefore the only one in which the HKMA does not have an interest. The CLS system is subject to the supervision of the Federal Reserve Bank of New York (New York Fed) and is exempted under section 11 of the CSSO from certain requirements under the Ordinance. The New York Fed leads a CLS Oversight Committee with representatives from all of the jurisdictions (including Hong Kong) whose currencies are members of the CLS system and the HKMA exercises oversight of CLS through this forum. The HKMA exercises on-going oversight of the five local designated systems: the CMU, HKD CHATS, USD CHATS, EUR CHATS and RMB CHATS. 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) link, the

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

BI-RTGS<sup>2</sup> – USD CHATS PvP link and the BAHTNET<sup>3</sup> – USD CHATS PvP link. Although these overseas systems are not overseen by the HKMA, the HKMA oversees these external links in cooperation with the respective home overseers.

1.5 The HKMA has implemented a number of measures to address the potential or perceived conflict of interest arising from the HKMA being the system operator or settlement institution of certain systems and also the overseer of designated systems. These include a clear segregation of duties within the HKMA and the promotion of transparency in the designation and oversight processes. In addition, the Process Review Committee (PRC), an independent, non-statutory committee, was established by the Chief Executive of the Hong Kong Special Administrative Region in December 2004 to review the processes and procedures adopted by the HKMA in applying oversight standards. Among other things, it seeks to ensure that the same set of standards is applied to all designated 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

---

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

<sup>3</sup> BAHTNET is the RTGS system for large value fund transfer between financial institutions or other organizations in Thailand.

designated systems in which the HKMA has a legal or beneficial interest, to the Financial Secretary.

1.7 The PRC has agreed that, in discharging its functions, the Committee should focus on whether there were any discrepancies in the HKMA's oversight of 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 fourth term of service. Members of the PRC are appointed by the Chief Executive of the Hong Kong Special Administrative Region in their personal capacity for a three-year term from 1 December 2013 to 30 November 2016. The membership of the PRC as at 30 November 2014 was:

#### Chairman

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

Director, EMBA Programme

The Chinese University of Hong Kong

#### Members

**Mr Chan Kay Cheung**

Vice-Chairman

Bank of East Asia (China) Limited

**Prof Stella Cho Lung Pui Lan**

Dean and Professor

Division of Business and Management

United International College  
Beijing Normal University-Hong Kong Baptist University

**Ms Joan Ho Yuk Wai**

Partner, Financial Services  
KPMG

**Ms Judy Wong Sau Pik**

Partner, Assurance  
Ernst & Young

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

2.1 This is the tenth Annual Report of the PRC, which covers the work of the Committee from 1 December 2013 to 30 November 2014. This is also the first annual report for the current term of the PRC.

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

2.2 The PRC held two meetings in 2014. At the first meeting in July, Members reviewed the regular report covering the oversight activities of the HKMA from December 2013 to March 2014. In particular, Members discussed how the HKMA handled the abnormal events encountered by the designated systems.

2.3 Members were also briefed on the launch of a third PvP link of USD CHATS, the USD-Thai Baht (THB) PvP link on 28 July 2014. The basic infrastructure of the link is similar to the existing Malaysian and Indonesian PvP links of USD CHATS. The link allows participants to settle USD/THB foreign exchange transactions on a PvP basis within the Asian time zone, with the USD and THB payments settled and delivered simultaneously through USD CHATS in Hong Kong and BAHTNET (RTGS system of Thailand) in Thailand respectively.

2.4 At the second meeting held in November, Members reviewed the regular report covering the period from July to September 2014, and were briefed on the oversight activities conducted by the HKMA during October and November. They commented on the drafting of the Committee's tenth annual report to be submitted to the Financial Secretary. Members were briefed on the latest developments regarding the Clearing and Settlement Systems (Amendment) Bill.

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 2014. Members noted that the HKMA had met the performance benchmarks for oversight activities.

### **Comments and recommendations of the PRC**

2.7 The format of the regular report and the accompanying oversight activities management reports were designed based on suggestions from Members. During the year, Members reviewed four regular reports and 23 accompanying oversight activities management reports covering the period from December 2013 to November 2014. 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 2013 to Nov 2014**

<b>HKMA's oversight activities conducted during the quarter</b>	<b>1<sup>st</sup> Regular Report (Dec- Mar)</b>	<b>2<sup>nd</sup> Regular Report (Apr-Jun)</b>	<b>3<sup>rd</sup> Regular Report (Jul-Sep)</b>	<b>4<sup>th</sup> Regular Report (Oct-Nov)</b>
Processing of monthly return submitted by SO/SI	36	27	27	18
Vetting of changes in particulars of SO/SI	8	7	7	1
Reviewing of ad-hoc information submitted by SO/SI	60	41	32	33
Granting approval to changes in operating rules	2	9	5	16
Conducting on-site examinations	0	0	1	0
Handling of abnormal events/ production incidents	11	6	5	4
Handling of contravention cases	0	0	0	0
Holding of meetings with management of SO/SI	1	0	0	0

2.8 At the meeting in July, Members noted that in order to ensure that the USD-THB link would not affect the safety and efficiency of USD CHATS, the HKMA (i) had conducted a risk assessment of the link, including the legal, credit, liquidity and operation risks that may be posed to the USD CHATS, (ii) had noted that appropriate system testing had been completed, and contingency arrangements and contact lists had been put in place before the launch of the link, (iii) considered that the risks identified were manageable and necessary controls were in place, and (iv) had established contact with the Bank of Thailand (as the overseer of BAHTNET) to work out a co-operative oversight arrangement and had proposed a Memorandum of Understanding.

2.9 At the meeting in November, Members noted that the HKMA conducted in July 2014 an on-site examination on HKICL, the system operator of the CHATS systems, focusing on (i) the adequacy of physical and logical access control of the CHATS systems at both the primary and secondary sites of HKICL and (ii) the adequacy of data security for protecting participant information and RTGS transaction data. An exit meeting was held with the management of HKICL to discuss the findings and recommendations of the examination, and an external examination report summarising the findings and recommendations was issued to HKICL, in line with the requirements set out in the Internal Operating Manual.

2.10 Members also noted the implementation progress of the Principles for Financial Market Infrastructures (PFMIs) in Hong Kong. The PFMIs are the new international standards published by the Bank for International Settlements Committee on Payment and Settlement Systems (CPSS)<sup>4</sup> and the International Organization of Securities Commissions (IOSCO) in April 2012. 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. All local designated systems completed and disclosed publicly on their websites the CPSS-IOSCO disclosure framework for FMIs in accordance with the PFMI requirements. The HKMA has begun to conduct formal assessments of the local designated systems against the PFMIs.

---

<sup>4</sup> The CPSS changed its name to the Committee on Payment and Market Infrastructures (CPMI) in September 2014.

2.11 A draft of the annual report was discussed at the meeting in November 2014. 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.

2.12 Members were briefed on the background of the Clearing and Settlement Systems (Amendment) Bill, which is intended to extend the regulatory framework to cover retail-level stored-value facilities and payment systems in addition to the existing large-value clearing and settlement systems designated under the CSSO. The Bill is expected to be introduced to the Legislative Council in the 2014-2015 legislative year, and Members will be kept informed of developments and any possible implications to the work of the PRC.

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

3.1 During the period, the PRC reviewed four regular reports and 23 accompanying oversight activity management reports covering the period from December 2013 to November 2014. 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 23 cases of changes in particulars, granting approvals to 32 changes in operating rules, handling of 26 abnormal events and production incidents, reviewing of 166 submissions of ad-hoc information and holding of one meeting with the management of the SOs and the SIs.

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

3.3 The PRC will continue to review the processes and procedures adopted by

the HKMA in overseeing the existing designated systems and, where appropriate, any additional systems that may be overseen by the HKMA under the CSSO in the coming years.