

Process Review Committee

Annual Report to the Financial Secretary 2017-2018

I. GENERAL INFORMATION

Background of establishment

1.1 The Payment Systems and Stored Value Facilities Ordinance (PSSVFO) empowers the Monetary Authority (MA) to designate and oversee clearing and settlement systems that are material to the monetary or financial stability of Hong Kong or to its functioning as an international financial centre or having regard to matters of significant public interest. The purpose of the PSSVFO is, among other things, to promote the general safety and efficiency of designated clearing and settlement systems (CSSs).

1.2 To date, six CSSs have been designated under the PSSVFO. They are:

- (a) the Central Moneymarkets Unit (CMU)
- (b) the Hong Kong Dollar Clearing House Automated Transfer System (HKD CHATS)¹
- (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)²
- (f) the Continuous Linked Settlement (CLS) System

1.3 The system operators (SOs) and settlement institutions (SIs) of the

¹ The Faster Payment System (FPS) was launched on 17 September 2018 as extensions of the HKD CHATS and RMB CHATS respectively to provide 7 x 24 real-time clearing and settlement services for HKD and RMB retail payment transactions. Similar to CHATS transactions, FPS transactions enjoy settlement finality under the PSSVFO.

² The FPS also supports RMB transactions. See footnote 1.

designated CSSs are set out in the following table:

Table 1:

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

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

1.4 The HKMA is the owner/operator of HKD CHATS and the CMU, and has a 50% stake in the Hong Kong Interbank Clearing Ltd. (HKICL), which is the system operator of the four CHATS systems and provides computer support to the CMU (The Hong Kong Association of Banks (HKAB) holds the other 50% of shares in HKICL). Of the six designated CSSs, the CLS System is the only one in which the HKMA does not have an interest. The CLS System is subject to the supervision of the Federal Reserve Bank of New York (FRBNY) and is exempted under section 11 of the PSSVFO from certain requirements under the Ordinance. FRBNY leads a CLS Oversight Committee with representatives from all of the jurisdictions (including Hong Kong) whose currencies are members of the CLS system and the HKMA exercises oversight of CLS through this forum. The HKMA exercises on-going oversight of the five local designated CSSs: the CMU, HKD CHATS, USD CHATS, EUR CHATS and RMB CHATS. Some of these designated CSSs have established links with overseas payment or securities settlement systems to facilitate cross-border transactions, for example, the payment-versus-payment (PvP) and the delivery-versus-payment (DvP) link between USD CHATS and RENTAS³ in

³ RENTAS is the RTGS clearing and settlement system for inter-bank fund transfer and scripless securities trading in Malaysia.

Malaysia, the PvP link between USD CHATS and BI-RTGS⁴ in Indonesia and the PvP link between USD CHATS and BAHTNET⁵ in Thailand. Although these overseas systems are not overseen by the HKMA, the HKMA oversees these external links in cooperation with the respective home overseers.

1.5 The HKMA has implemented a number of measures to address the potential or perceived conflict of interest arising from the HKMA being the SO or SI of certain CSSs and also the overseer of designated CSSs. These include a clear segregation of duties within the HKMA and the promotion of transparency in the designation and oversight processes. In addition, the Process Review Committee (PRC), an independent, non-statutory committee, was established by the Chief Executive of the Hong Kong Special Administrative Region (CE/HKSAR) in December 2004 to review the processes and procedures adopted by the HKMA in applying oversight standards. Among other things, it seeks to ensure that the same set of standards is applied to all designated CSSs, whether or not the HKMA has an interest in them.

Scope of work and terms of reference

1.6 The terms of reference of the PRC are:

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

⁴ BI-RTGS is the RTGS clearing and settlement system for inter-bank fund transfer in Indonesia.

⁵ BAHTNET is the RTGS system for large value fund transfer between financial institutions or other organisations 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 designated CSSs in which the HKMA has an interest, as compared with other systems. In other words, the PRC would review the processes and procedures adopted by the HKMA to ensure that the same oversight standards were applied to all designated CSSs. The PRC also agreed that its scope could be expanded in future if the HKMA had a legal or beneficial interest in a designated retail payment system (RPS) or a licensed stored value facility (SVF) under the PSSVFO. This is consistent with the policy intention of the establishment of the PRC in 2004. So far, the HKMA had not acquired any interest in any designated RPS or licensed SVF under the PSSVFO.

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

Membership of the PRC

1.9 The PRC is in its fifth term of service. Members of the PRC are appointed by the CE/HKSAR in their personal capacity for a three-year term from 1 December 2016 to 30 November 2019. The membership of the PRC as at 30 November 2018 was:

Chairman

Professor Francis Chin Yuk-lun

Emeritus and Honorary Professor
Department of Computer Science
The University of Hong Kong

Members

Ms Annie Chan Wai-hing

Managing Director
Mazars Corporate Recovery & Forensic Services Limited

Ms Joan Ho Yuk-wai

Certified Public Accountant

Ms Sabita Prakash

Managing Director

Asia Debt Management Hong Kong Limited

Mr Michael Shue

Executive Director

Nerine Trust Company (Hong Kong) Limited

II. HIGHLIGHTS OF THE WORK OF THE PRC

2.1 This is the 14th Annual Report of the PRC, which covers the work of the Committee from 1 December 2017 to 30 November 2018. This is also the second 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 2018. At the first meeting in July, Members reviewed the regular report covering the oversight activities of the HKMA from December 2017 to March 2018 and was briefed on the oversight activities conducted by the HKMA from April to June 2018. In particular, Members discussed how the HKMA handled abnormal events encountered by the designated CSSs, and the HKMA's preparations regarding the designation and oversight of the Faster Payment System (FPS) which was being developed and was scheduled for launch in September 2018. Members also noted that the HKMA was formulating the oversight framework of the FPS based on the existing oversight standards and requirements imposed on CHATS and reviewing the Internal Operating Manual for the purpose of overseeing FPS.

2.3 At the second meeting held in November, Members reviewed the regular report covering the period from July to September 2018, and was briefed on the oversight activities conducted by the HKMA from October and November 2018. They discussed the drafting of the Committee's 14th annual report to be submitted to the Financial Secretary. Members were also briefed on the HKMA's implementation of the FPS oversight framework, the operation of the FPS and the corresponding oversight activities that had commenced with the launch of the FPS in September 2018. Members also noted that the Internal Operating Manual had been updated to provide for the new oversight framework for the FPS and to cater for updated procedures in relation to the handling of contraventions under the PSSVFO.

2.4 Specifically, in the light of the launch of the FPS in September 2018, Members were briefed at the meetings on the HKMA's designation and oversight approach on the FPS as well as the implementation progress of the relevant oversight

framework. Members noted that the FPS is: (i) a multicurrency real-time clearing and settlement system operating round-the clock covering HKD and RMB payment transactions; (ii) being treated as an extension of the existing CHATS with settlement finality given the similarities shared between the FPS and CHATS; and (iii) subject to the HKMA's oversight under the PSSVFO with effect from its launch. Members noted that given the FPS' role as an important piece of FMI serving the retail segment with unique system features, the HKMA had formulated a new framework to oversee the FPS, which included (i) oversight requirements currently applied to CHATS being CSSs; (ii) applicable Principles for Financial Market Infrastructures issued jointly by the Committee on Payments and Market Infrastructures of the Bank for International Settlements and the International Organization of Securities Commissions; and (iii) drawing reference from relevant overseas experiences in overseeing faster payment systems. Members also noted that the HKMA would keep in view the suitability and adequacy of the FPS oversight framework on an on-going basis taking into account system behaviours, feedback from stakeholders, overseas developments, international guidance, etc., and consider fine-tuning the framework as appropriate. Members also noted the HKMA's oversight activities over the FPS since the launch of the system in September 2018, including meetings with the SO on system operation and enhancements issues and gathering of system statistics to facilitate monitoring of the performance of the FPS and the safety and efficiency of its operations.

2.5 As agreed by Members, regular reports covering the HKMA's oversight activities were sent to Members for review by circulation between meetings. If Members have questions about the reports, they may raise them with the Secretary of the Committee. Subject to the agreement of the Chairman, the questions will be discussed at the next regular meeting or, if needed, at a special meeting. During 2018, four regular reports had been circulated to Members for review. Members noted that the HKMA had met the performance benchmarks for oversight activities.

2.6 Besides regular meetings and reports, the Committee also made a site visit to HKICL in April 2018 which aimed to enable Members to have a better understanding of the operations of HKICL being the SO of the CHATS systems. This in turn facilitated the Committee to effectively discharge its functions in reviewing the processes and procedures adopted by the HKMA in applying the same

oversight standards across the designated CSSs.

Comments and recommendations of the PRC

2.7 The format of the regular report and the accompanying oversight activities management reports were designed based on suggestions from Members. During the year, Members reviewed four regular reports and 36 accompanying oversight activities management reports covering the period from December 2017 to November 2018. 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 2017 to Nov 2018

HKMA's oversight activities conducted during the quarter	1st Regular Report (Dec- Mar)	2nd Regular Report (Apr-Jun)	3rd Regular Report (Jul-Sep)	4th Regular Report (Oct-Nov)
Processing of monthly return submitted by SO/SI	36	27	27	18
Vetting of changes in particulars of SO/SI	26	7	6	5
Reviewing of ad-hoc information submitted by SO/SI	46	28	40	34
Granting approval to changes in operating rules	0	6	6	8
Conducting on-site examinations	0	0	0	0
Handling of abnormal events/ production incidents	15	9	8	10
Handling of contravention cases	0	0	0	0
Holding of meetings with management of SO/SI	6	0	0	0

2.8 At the meeting in November 2018, Members discussed a draft of the annual report. Members had made some comments on the draft and 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 36 accompanying oversight activities management reports covering the period from December 2017 to November 2018. 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 44 cases of changes in particulars, granting of approvals to 20 changes in operating rules, handling of 42 abnormal events and production incidents, reviewing of 148 submissions of ad-hoc information and holding of 6 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 CSSs and, where appropriate, any additional designated systems or licensed SVF under the PSSVFO in which the HKMA has a legal or beneficial interest.