Banking Stability

In 2014, the HKMA focused its supervisory efforts on authorized institutions' (AIs) credit risk and liquidity risk management, Mainland China-related lending, anti-money laundering controls, and the selling practices for investment and insurance products. In banking developments, the second phase of Basel III capital standards and the Basel III Liquidity Coverage Ratio were implemented. The HKMA completed a public consultation on enhancing the Deposit Protection Scheme and, to help promote AIs' customer-centric culture and capacity building, undertook various initiatives to ensure appropriate development for bank directors. And the enhanced competency framework for private wealth management practitioners was launched. The HKMA also worked with the industry to complete the review of the Code of Banking Practice and continued to promote the smart and responsible use of banking services through the Consumer Education Programme.

REVIEW OF 2014

Overview

With the monetary policies of the major advanced economies diverging, a slowdown in growth in Mainland China and rising property prices in the local market, the HKMA continued to monitor closely AIs' credit growth and Mainland-related business. This focused on banks' management of credit and liquidity risks and stress testing to ensure the resilience of the banking sector against any abrupt changes in the macroeconomic and market environment.

Operational supervision

In early 2014, the Banking Supervision Department was restructured to better align supervisory resources with the perceived key risks facing the banking industry over the next few years. Under the new structure, three divisions are responsible for the day-to-day supervision of individual AIs and topical subjects, such as consumer credit risk, supervisory stress testing and treasury market activities. Three specialist divisions supervise AIs' corporate sector credit risk, operational and technology risks, and money laundering and financial crime risk. The HKMA considers these three areas to be the most significant risks for the banking industry in the near term warranting dedicated supervisory resources.

During the year, the HKMA continued to further enhance its supervisory approach to enable more efficient use of supervisory resources. In particular, regular on-site examinations were replaced by thematic reviews and thematic on-site examinations. Thematic reviews are in-depth off-site reviews focusing on particular risk areas or specific activities of groups of selected AIs. Based on results of the thematic reviews, the HKMA prioritised its on-site examinations of AIs.

The HKMA performed a total of 216 on-site examinations. More in-depth thematic on-site examinations on Mainland-related lending activities were conducted given their increased significance to and potential risk implications on the Hong Kong banking sector. The HKMA increased the number of examinations on treasury related activities as well as the operational and technology risks of AIs. On-site examinations were also conducted on credit controls, stress testing and liquidity risk management, capital planning, re-developed internal ratings-based (IRB) models, and anti-money laundering and counter-terrorist financing (AML/CFT) controls of AIs. 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.

Furthermore, a total of 127 thematic reviews under the enhanced supervisory approach mentioned above were conducted covering similar areas as the thematic on-site examinations. Table 1 contains details of the operational supervision work.

In 2014, 197 off-site reviews were conducted to assess AIs' corporate governance, financial position and business operations. Supervisory attention focused on risk governance, credit growth, capital planning and readiness to implement the Basel III liquidity framework. The supervisory teams maintained frequent contact with the boards of directors and external auditors of selected AIs. 22 tripartite meetings were held with the senior management and external auditors of AIs, while 15 meetings were held with the full board or board-level committees of selected AIs.

The Banking Supervision Review Committee considered five cases, two concerning authorization of AIs, one relating to the approval of a money broker, one regarding upgrading the licence of an AI and one relating to a conduct issue.

To better utilise its supervisory resources to deal with competing priorities, the HKMA continued to invoke 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 six reports under this provision in 2014. Two of the reports covered AML/CFT controls and the remaining four were related to areas including governance and compliance framework, accounting issues, trading activities and wealth management business.

No AI breached the requirements of the Banking Ordinance relating to capital adequacy or liquidity ratio in 2014. There were 63 breaches under various sections of the Ordinance, but none affected the interests of depositors and they were rectified promptly by the AIs.

Table 1 Operational supervision

		2014	2013
1	On-site examinations	**216**	282
	Reviews of the internal ratings-based approach (IRB approach) and internal models approach (IMM approach)	**3**	12
	Capital planning	**3**	4
	Market risk, counterparty credit risk and treasury activities	**12**	2
	Stress testing and liquidity risk management	**13**	41
	Securities, investment products, insurance and Mandatory Provident Fund-related businesses	**20**	24
	Deposit Protection Scheme-related representation	**13**	12
	Code of Banking Practice/Consumer Protection	**1**	3
	Positive mortgage data sharing	**2**	2
	Anti-money laundering/counter-terrorist financing controls	**19**	19
	IT, Internet banking and operational risk	**45**	40
	Mainland-related business and Renminbi business	**61**	34
	Credit controls, credit risk management and asset quality	**16**	33
	Overseas examinations	**8**	9
	Local regular examinations	**–**	47
2	Thematic reviews	**127**	–
	Reviews of the IRB approach and stress testing	**12**	–
	Treasury activities	**36**	–
	Anti-money laundering/counter-terrorist financing controls	**15**	–
	IT, Internet banking and operational risk	**29**	–
	Credit controls	**35**	–
3	Off-site reviews and prudential interviews	**197**	193
4	Tripartite meetings	**22**	9
5	Meetings with board of directors or board-level committees of AIs	**15**	15
6	Approval of applications to become controllers, directors, chief executives or alternate chief executives of AIs	**299**	225
7	Reports commissioned under section 59(2) of the Banking Ordinance	**6**	7
8	Cases considered by the Banking Supervision Review Committee	**5**	7
9	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 operational and technology risks

To facilitate more effective risk supervision, the HKMA centralised and strengthened its resources for supervising operational and technology risks under a single division of the Banking Supervision Department.

New or updated guidance on operational and technology risk management was issued by the HKMA, including a circular and the inaugural issue of "Operational Incidents Watch" to highlight key lessons or prudent control practices arising from significant fraud cases or operational incidents; a circular to remind AIs of the importance of ensuring the availability of critical services and effective incident management; and a circular setting out the enhanced controls required for protecting customer data and dealing with customer data leakage. In addition, the HKMA continued working with the e-Banking Security Committee of the Hong Kong Association of Banks (HKAB) on updating the Supervisory Policy Manual (SPM) module in relation to the risk management of e-banking.

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

The HKMA also collaborated with the HKAB to develop industry guidelines on the control standards for AIs' Bring-Your-Own-Device[2] initiatives and security controls to protect automatic teller machines (ATMs) against emerging threats.

The HKMA adopted a forward-looking and risk-focused approach to conducting on-site examinations to evaluate AIs' operational or technology risk management at the enterprise level or specific business lines. These included AIs' treasury market and derivatives activities, processing of third-party fund transfer instructions received through email or fax, operational risk management frameworks, capturing and analysis of operational risk events, business continuity management and selected technology risk management controls. In addition, the HKMA has started examining the cyber security controls of individual AIs given the growing cyber threats worldwide.

A series of off-site surveillance or supervisory activities was carried out to assess the profile and trend of AIs' operational or technology risks and risk management controls. These covered the annual self-assessment of operational risk management and independent compliance assessment for internet banking, technology risk management and business continuity planning, and the associated follow-up actions taken in relation to selected AIs. Desktop reviews were conducted to assess selected AIs' controls that were not covered by on-site examinations. Surveys were conducted to monitor AIs' status in implementing specific operational or technology controls, including the chip-based ATM technology. As regards significant operational incidents that occurred during the year, the HKMA also monitored whether AIs had implemented appropriate measures to prevent such events from recurring. In light of an increased risk of widespread disruptions to AIs' key business operations in main business districts, the HKMA organised drills involving over 50 AIs to test their ability to deal with such scenarios.

Supervision of wealth management 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' sale of securities, investment products, insurance products and Mandatory Provident Fund (MPF) schemes. Regular contact was maintained with the other regulators through bilateral and multilateral meetings, as well as under the auspices of the Council of Financial Regulators.

The HKMA also worked with the private wealth management industry and relevant training institutes to develop the enhanced competency framework (ECF) for industry practitioners, taking into account comments received during consultation with the industry in 2013. The ECF, which covers enhanced core competence and continuous professional development for private wealth management practitioners, was launched in June. The HKMA issued a circular to encourage private banks to adopt the ECF and has been monitoring implementation of the framework. Guidance was also provided to the industry and training institutes in the development and quality assurance of study materials, training programmes and examinations under the ECF.

A new half-yearly survey on the sale of investment products to private banking customers by registered institutions (RIs) commenced last year. The survey facilitates the HKMA's off-site surveillance of such activities and assists in prioritising supervisory resources to focus on any emerging issues.

The HKMA processed two applications from RIs to engage in additional regulated activities. It granted consent to 167 Executive Officers responsible for supervising the securities activities of RIs, and conducted background checks on 9,368 individuals whose information was submitted by RIs for inclusion in the register maintained by the HKMA.

[2] Bring-Your-Own-Device refers to the use of computing devices (e.g. personal computers, tablets and smart phones) personally-owned by staff members for work.

In 2013 and 2014, the HKMA engaged a service provider to undertake a mystery shopping programme to assess AIs' sales practices in respect of investment and insurance products. A report on the results of the programme was published in December, and AIs were required to study the findings and encouraged to adopt the good practices set out in the report.

During the year, 20 on-site examinations were conducted on retail and private banks covering the selling of investment products, handling the settlement of securities transactions and safe custody of client securities, and the selling of non-linked long term insurance (NLTI) products and MPF-related products. The HKMA also continued to carry out on-site examinations and off-site surveillance to assess AIs' compliance with the performance requirements under the MPF intermediaries' regulatory regime.

The HKMA issued a comprehensive framework in March to set out the regulatory standard for the calculation of asset concentration in foreign exchange accumulators. In July, a circular was issued to highlight the findings and good practices in relation to the sale of investment products identified in the HKMA's ongoing supervision, and to remind AIs to comply with the regulatory requirements and expected standards.

The HKMA's supervisory work also identified various areas for improvement in AIs' selling practices in relation to NLTI products. To ensure appropriate protection for bank customers, and after consultation with the OCI and the banking industry, the HKMA issued guidance in December on the expected practices AIs should adopt when selling NLTI products.

In accordance with the standardised calculation methodology and disclosure format regarding intermediaries' remuneration for the sale of investment-linked assurance scheme (ILAS) products, which was issued by the OCI after consultation with the HKMA, the Hong Kong Federation of Insurers revised the remuneration disclosure statement. The revision, contained in the Important Facts Statement (IFS) and announced by the Federation in December, made it applicable to all distribution channels including AIs no later than 1 January 2015. In the same month, the HKMA issued a circular informing AIs they would need to adopt the revised remuneration disclosure statement in making pre-sale disclosure of remuneration in the sale of ILAS products, and to provide guidance to AIs on the standards expected for pre-sale remuneration disclosure and implementing the IFS requirements. At the same time, the remuneration disclosure requirement for ILAS prescribed by the HKMA in 2013 was superseded.

The Insurance Companies (Amendment) Bill 2014, which seeks to establish an independent Insurance Authority and a statutory licensing regime for insurance intermediaries, was introduced into the Legislative Council in April. The HKMA has been working with the Financial Services and the Treasury Bureau (FSTB) in the legislative process on AIs' insurance intermediary activities.

Supervision of treasury activities

The HKMA continued to devote resources to assessing AIs' control over market risk, counterparty credit risk and liquidity risk arising from their treasury and derivatives activities. In 2014, the HKMA conducted three on-site examinations on AIs' control frameworks for managing market and counterparty credit risk and 15 thematic on-site examinations on selected AIs' compliance with the standards and guidance set out in the SPM module on "Sound Systems and Controls for Liquidity Risk Management". In addition, following the issuance of the SPM module on "Code of Conduct for Benchmark Submitters" in August 2013, the HKMA conducted 23 thematic reviews on AIs' HIBOR submission systems and controls during 2014.

Supervisor-driven stress testing programme

The HKMA continued to conduct the bottom-up supervisor-driven stress testing programme 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 times of stress. A number of enhancements were introduced during the year to make the scope of the stress test more comprehensive. The HKMA has analysed the results submitted by the participating AIs and discussed with them how their processes could be further improved.

Credit risk management and asset quality

Credit growth and asset quality

The banking sector's total lending increased by 12.7% during 2014, compared with 16% in 2013 (Table 2). As loan growth outpaced the increase in customer deposits, the overall loan-to-deposit ratio increased to 72.2% at the end of 2014 from 70.3% a year ago. The asset quality of the banking sector remained sound with the classified loan ratio standing at 0.51% at the end of the year.

Table 2 **Growth in loans and advances**

% change	**2014**	2013
Total loans and advances	**12.7**	16.0
Of which:		
– for use in Hong Kong	**13.9**	10.6
– trade finance	**-1.4**	43.8
– for use outside Hong Kong	**14.2**	21.5

The HKMA remained vigilant in ensuring that AIs' credit risk is prudently managed to support their loan growth.

To promote prudent credit underwriting standards, the HKMA assessed, through thematic on-site examinations and thematic reviews, the adequacy and effectiveness of AIs' credit risk management systems. Where weaknesses were identified, the HKMA required the AIs to take appropriate remedial action within a reasonable time. For more significant issues identified, the AIs were required to commission an independent party to conduct a more in-depth review and take appropriate action to rectify weaknesses as soon as practicable. In particular, the HKMA issued a circular reminding AIs to adopt prudent practices for the management of guarantees as credit risk mitigates.

Stable Funding Requirement

The Stable Funding Requirement (SFR) was implemented in January 2014 to ensure AIs could maintain stable business operations in the event market liquidity came under stress. Taking into consideration industry feedback and implementation experience of the SFR, the HKMA conducted a review in October with the aim of streamlining its operations and alleviating AIs' reporting burden. A circular was issued in November to formalise the implementation of the refined SFR effective from 1 January 2015.

Prudential supervision of mortgage loans

The HKMA remained vigilant towards AIs' property mortgage business, which make up a significant portion of their lending portfolios. In view of the increased risk of a property price bubble in recent years, the HKMA introduced six rounds of countercyclical prudential measures between October 2009 and February 2013 to enhance AIs' resilience to the risk of a severe adjustment in property prices. These measures included requiring AIs to tighten the maximum loan-to-value ratios for riskier property mortgages; apply more prudent criteria in assessing the repayment ability of mortgage loan applicants; limit the maximum loan tenor for all new property and stand-alone car park space mortgage loans; and share positive mortgage data. In addition, the HKMA required AIs adopting the IRB Approach to introduce a 15% risk weight floor for all new residential mortgage loans. The HKMA will continue to closely monitor the property and mortgage lending markets and will adjust the relevant measures as and when necessary in response to developments in the property market cycle.

Prudential supervision of personal loans

In the light of rising household indebtedness since the global financial crisis and intense competition among banks in personal lending business, the HKMA issued a circular in January 2014 requiring AIs to adopt more prudent underwriting standards on personal loans. This included setting binding debt servicing ratio (DSR) limits, refraining from offering personal loans with long tenors, establishing portfolio-based limit structures and conducting internal stress testing.

A survey conducted by the HKMA in May on 23 AIs active in personal lending found there were variations in their relevant risk management policies and practices. This was followed up in July when a briefing session was held for the senior management of the surveyed AIs. Among other requirements, the HKMA's expectations derived from the observed market norms, such as a maximum DSR of 70% and a maximum loan tenor of 60 months, were raised as references for limits on personal loans. The AIs are required to follow these expectations and the HKMA will assess their enhanced risk management controls as part of its ongoing supervision.

US tapering and monetary policy normalisation

The US Federal Reserve ended its asset purchase programme in October following improvements in the labour market and persistent low inflation in the US. As the US economy continues to gather momentum, the market widely expects that the US policy rate will increase in 2015, signalling the beginning of monetary policy normalisation.

The prospect of higher interest rates in the US, coupled with the recent strengthening of the US dollar, may have significant implications on fund flows to Hong Kong. Although a strong recovery in the US economy may have positive implications on the Hong Kong economy, a sudden or significant reversal of fund flows may lead to volatility in asset prices and potentially jeopardise Hong Kong's financial stability. The HKMA has been closely monitoring developments and taken steps to contain the potential adverse impact of monetary policy normalisation in the advanced economies. AIs are required to be prudent in managing their liquidity and interest rate risks to cater for possible fund outflows, and the HKMA has incorporated such a scenario in its supervisory liquidity stress testing.

Mainland-related business

Mainland-related lending

The role of Hong Kong as a regional hub for financial intermediation has become more prominent in recent years as a result of Hong Kong's increasing financial and economic co-operation with Mainland China. This has contributed to the increase in the local banking sector's Mainland-related lending.

In 2014, the banking sector's total Mainland-related lending increased by 19.1%, to HK$3,117 billion at the end of 2014 (Table 3). This included HK$550 billion of loans booked at the Mainland subsidiaries of Hong Kong-based banks.

Table 3 Mainland-related lending

HK$ billion	**2014**	2013
Total Mainland-related lending	**3,117**	2,616
Of which:		
– Mainland-related lending excluding trade finance	**2,775**	2,301
– trade finance	**341**	315

Note: Figures may not add up to total due to rounding.

As a result of the continuing rise in Mainland-related lending by AIs, the HKMA has stepped up surveillance and introduced regular surveys requiring AIs active in such lending to report more frequent and detailed information to the HKMA for analysis.

Prevention of money laundering and terrorist financing

The Anti-Money Laundering and Financial Crime Risk Division was established in March to strengthen and consolidate the resources for AML/CFT supervision. By adopting a forward-looking and proportionate approach, the HKMA's supervision focuses on identifying significant and emerging risks, and ensuring that AIs' AML/CFT controls are effective in addressing these risks. 21 on-site examinations (including 2 overseas examinations) and 15 desk-based reviews were conducted in 2014, a number of which were thematic, picking up on important AML/CFT areas such as controls over financial sanctions.

To ensure money laundering and terrorist financing risks are properly assessed by each AI and that the results of the HKMA's assessments are used effectively in the design of AIs' AML/CFT systems, the HKMA performed desk-based reviews supplemented by training and guidance to the banking industry. Increased attention has also been given to AI's AML/CFT compliance culture and how money laundering and terrorist financing risks are managed by AIs' senior management.

Internationally, the HKMA maintains engagement with the global AML/CFT community to ensure that its supervisory approach is consistent with the international standards and other financial centres. The HKMA participated in one of the first Financial Action Task Force Assessments under the new standards during 2014 and is also an active participant in the AML/CFT Expert Group established by the Basel Committee.

Risk governance

The HKMA stepped up efforts to instil a strong risk culture within AIs, particularly in terms of engagement with the boards of directors of local retail banks or their board-level committees on management oversight of internal controls and accountability for risk management. Feedback and comments on the performance of board members or board committee members were provided generally or on specific supervisory matters. A survey on the roles and authority of chief risk officers of local retail banks was conducted to ascertain the prevailing risk governance structure. A preliminary review of the risk appetite statements of local retail banks was carried out to take stock of the current standards and to suggest improvements with reference to relevant guidance issued by the Financial Stability Board (FSB).

Co-operation with overseas supervisors

The HKMA participated in college-of-supervisors meetings organised by the home supervisors of 20 banking groups with significant operations in Hong Kong. Issues of common interest were discussed, including key areas of supervisory focus, financial performance, stress testing, credit, operations, anti-money laundering and other types of risk management and supervisory issues relating to these banking groups.

Bilateral meetings were held during the year with banking supervisors from Australia, France, Germany, India, Japan, the Mainland, Malaysia, the Netherlands, the Philippines, Singapore, Switzerland, Taiwan, the UK and the US to ensure effective co-operation and co-ordination. There were also regular exchanges with overseas authorities on institution-specific issues and developments in financial markets.

The HKMA participated in the crisis management groups (CMGs) of 10 banking groups organised by the relevant home authorities to discuss resolution strategy and oversee production of the recovery and resolution plans of each banking group in accordance with the principles established by the FSB. The HKMA also participated in the pilot resolvability assessments for four of these groups. As an FSB member, the HKMA contributed its views on proposals for the loss-absorbing capacity of the global systemically important banks in resolution, the cross-border resolution framework, and funding for firms in resolution in the Cross-Border Crisis Management working group. The HKMA organised a regional CMG for the host regulators from the Asia-Pacific region about a local banking subsidiary of one UK-based international bank with extensive operations in the region.

Basel III

Implementation of Basel III in Hong Kong

The HKMA implemented the second phase of the Basel Committee on Banking Supervision's Basel III capital standards with the Banking (Capital) (Amendment) Rules 2014 (BCAR 2014), which came into effect on 1 January 2015 in accordance with the Basel Committee's transition timetable.

Capital standards

Pillar 1

The second phase of Basel III implementation introduced capital buffer requirements for AIs, namely a capital conservation buffer (CB), a countercyclical capital buffer (CCyB) and, for those AIs designated as systemically important, a higher loss absorbency (HLA) requirement. These buffer requirements are designed to provide incentives to AIs to build up and hold, outside periods of stress, an additional layer of Common Equity Tier 1 (CET1) capital over and above the "hard" minimum CET1 capital ratio. Each of the three buffer requirements is expressed as a ratio of an AI's CET1 capital to its total risk-weighted assets. AIs may operate within the "buffer zone" but will be subject to restrictions on their ability to make discretionary distributions while their CET1 capital levels are within the "zone". In order to avoid distribution constraints, an AI will need to maintain —

(a) a CB of 2.5%;

(b) a CCyB ranging from 0% to 2.5%, which is specific to each AI as it is determined as the weighted average of the CCyBs set by the relevant authorities of the jurisdictions in which that AI has private sector credit exposures; and

(c) if the AI is designated by the HKMA as systematically important either globally, as a global systemically important bank (G-SIB), or domestically as a domestic systemically important bank (D-SIB), an HLA requirement ranging from 1% to 3.5%, depending on the AI's perceived level of systemic importance.

In line with the Basel Committee timetable, the CB, CCyB and HLA requirements will be phased in, through equal annual increments, from 2016 to 2019. However, in the case of the CCyB, the HKMA may, under certain conditions specified in the Banking (Capital) Rules (BCR), accelerate the phase-in of the Hong Kong CCyB rate and/or set it at a level above 2.5%.

Pillar 2

The HKMA anticipated the 2016 implementation of the Basel III capital buffers when making changes in 2013 to its "Supervisory Review Process" (SRP, the local Pillar 2 framework) to accommodate the Basel III framework generally. The changes made to the SRP were designed to address any potential overlap between the existing Pillar 2 capital requirements and the capital buffers when the latter come into effect. Therefore, no further changes were required to the SRP in 2014. The basic concept underpinning the HKMA's SRP remains that Pillar 2 capital is, and will continue to be, a constituent part of an AI's minimum regulatory capital requirements.

Basel III (continued)

Pillar 3

The implementation of the second phase of Basel III also introduces new disclosure requirements for AIs from 2015 in connection with their capital buffers, the Liquidity Coverage Ratio, and the Leverage Ratio. To this end, the Banking (Disclosure) Rules (BDR) were amended by a set of Banking (Disclosure) (Amendment) Rules 2014 (BDAR 2014), which were published in the Gazette on 24 December 2014, and came into operation on 31 March 2015.

Liquidity standards

In addition to strengthening regulatory capital requirements, Basel III introduces the first global liquidity standards, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), to improve banks' resilience to liquidity stress. The standards are accompanied by a complementary set of liquidity monitoring tools for supervisors' surveillance of banks' liquidity risk exposure to further strengthen and promote consistency in liquidity risk supervision globally.

To implement the Basel III liquidity standards, the HKMA issued a set of Banking (Liquidity) Rules (BLR) in October 2014 which came into operation from 1 January 2015.

Under the BLR, the LCR applies to those AIs designated by the HKMA as "category 1 institutions". These are principally internationally active AIs or those larger or more sophisticated AIs that are significant to the general stability of the local banking system. Other AIs not designated as category 1 institutions (category 2 institutions) are subject to a Liquidity Maintenance Ratio (LMR), which is a modified version of the Liquidity Ratio applicable to all AIs prior to 2015.

To facilitate the smooth implementation of the new liquidity regime, a Code of Practice was issued in December 2014 to provide technical guidance on the calculation of total net cash outflows which is the denominator of the LCR. A set of standard calculation templates, which form the basis of the regulatory Return of Liquidity Position of an AI, have also been developed to facilitate AIs' calculation and reporting of the LCR and the LMR where applicable. The Code of Practice and the templates commenced operation, together with the BLR, from 1 January 2015.

A modified version of the NSFR was published by the Basel Committee in October 2014, following public consultation. Major modifications to the NSFR included the recalibration of various classes of available stable funding (ASF) and required stable funding (RSF) items to —

(i) better address potential funding risks relating to certain types of transaction (principally derivative transactions) and funding models (such as secured or unsecured short-term wholesale funding models);

(ii) enhance coherence with the concepts underlying the LCR (including preferential treatment for funding transactions conducted with central banks or collateralised by high quality liquid assets (HQLA)); and

(iii) introduce a more granular term structure, by dividing the original 12-month time horizon into two 6-month periods, to better reflect the liquidity risk attributes of ASF and RSF items maturing in different periods.

Basel III (continued)

The Basel Committee's intention is that the revised NSFR standard should be implemented from 1 January 2018. The HKMA will review the revised requirements in 2015 and consider the most appropriate approach for implementing the standard in Hong Kong.

Leverage ratio

Basel III introduces a simple non-risk-based leverage ratio as a complementary measure to the risk-based capital requirements to limit the potential for excessive leverage within banks. Under the Basel Committee's implementation timetable, the leverage ratio is initially subject to a parallel run from 2013 to 2017 when banks are required to report their leverage ratios to their supervisory authorities for regulatory monitoring, before the leverage ratio becomes a binding requirement from 2018. Disclosure of banks' leverage ratios is scheduled to begin in 2015. All Hong Kong-incorporated AIs have been required to report their leverage ratio positions quarterly to the HKMA for the purposes of the parallel run, and amendments were made to the BDR, through the BDAR 2014, to introduce the public disclosure requirements.

SIFI framework

Following initial industry consultation, the HKMA issued a draft SPM module on "Systemically Important Banks" in October 2014. The draft module, which complements the BCR, sets out the HKMA's assessment methodology for identifying AIs in Hong Kong to be designated as D-SIBs or G-SIBs and for calibrating the level of any additional HLA capital requirements to which they will be subject. The module also discusses other policy and supervisory measures to be applied to local D-SIBs and G-SIBs to address the risks they pose.

Supplementary guidance for Basel III implementation

An updated SPM module providing an "Overview of Capital Adequacy Regime for Locally Incorporated Authorized Institutions" and reflecting the current regulatory capital framework in Hong Kong under Basel III, was issued for industry consultation in September 2014. The module was gazetted in February 2015.

The HKMA also issued in December an updated set of FAQs to clarify the application of various provisions in the BCR and the BDR.

To explain its proposed approach to implementing the CCyB and to setting appropriate CCyB rates in Hong Kong, the HKMA issued in January 2015 a SPM module on "Countercyclical Capital Buffer (CCyB) — Approach to its Implementation". As an AI's specific CCyB requirement is determined by the geographic mix of its private sector credit exposures and the CCyB rates applicable in the jurisdictions in which it operates, the HKMA, in November 2014, set out guidance in another separate SPM module on "Countercyclical Capital Buffer (CCyB) — Geographic Allocation of Private Sector Credit Exposures", to explain how an AI's private sector credit exposures should be allocated geographically for CCyB purposes.

Basel III (continued)

Basel III implementation monitoring process

Since 2011, the HKMA has been contributing data from selected locally-incorporated AIs for the Basel Committee's quantitative impact study (QIS) to facilitate assessment of the impact of the Basel III capital[3] and liquidity requirements and the monitoring of banks' progress in their implementation.

The HKMA also carried out a similar QIS locally on liquidity, covering a broader sample of AIs. The information collected in the QIS has enabled the HKMA to better assess the effects of the liquidity standards on different types of AI (such as those that are incorporated outside Hong Kong, wholesale-oriented in their business, or predominantly retail-based) and has been helpful for the HKMA's policy decisions on implementing the liquidity standards in Hong Kong.

Basel Committee Regulatory Consistency Assessment Programme

The Basel Committee established its Regulatory Consistency Assessment Programme (RCAP) in 2012 to monitor, assess and evaluate its members' implementation of the Basel standards. A key objective of the RCAP is to assess the consistency of the implementation of a jurisdiction's capital and liquidity requirements in relation to the minimum standards set out in the Basel II, Basel 2.5 and Basel III standards. By promoting full, timely and consistent implementation of the Basel standards, RCAP helps strengthen the international banking system, improve market confidence in regulatory ratios, and ensure a level playing field. Ultimately, all Basel Committee member jurisdictions will be expected to undertake at least one round of RCAP assessment by 2016. The RCAP assessment of Hong Kong (covering both capital and liquidity standards) was conducted by the Basel Committee in 2014. The RCAP reports for Hong Kong were published in March 2015. Overall, Hong Kong's capital and liquidity regulations were assessed as "compliant" with the Basel standards.

In addition to being assessed under the RCAP, the HKMA participated in RCAP assessments of other jurisdictions during the year. The HKMA joined technical experts from Australia, Japan, Mexico, Switzerland and the US to complete an assessment of the European Union, the report of which was published in December 2014. The HKMA, as a leader of an international team, was also in the process of conducting an RCAP assessment of India.

3 In the case of capital requirements, the impact is assessed on a fully implemented basis, including capital buffers and HLA requirements for systemically important financial institutions.

Improving Supervisory Policy Framework

Regulation of over-the-counter (OTC) derivatives transactions

In April, LegCo enacted the Securities and Futures (Amendment) Ordinance 2014 (Amendment Ordinance), which provides a regulatory framework for the OTC derivatives market in Hong Kong to meet relevant G20 commitments. The framework will be overseen by SFC for licensed corporations and central counterparties, and the HKMA for AIs and approved money brokers (AMBs). It provides for the imposition of mandatory obligations on the reporting, clearing and trading of specified OTC derivatives transactions, and introduces complementary record keeping requirements.

The HKMA will develop supervisory guidelines to support the phased implementation of the new framework for AIs and AMBs. As the first phase of implementation, covering mandatory reporting and related record keeping obligations, is expected to take effect within the first half of 2015, the HKMA intends to issue the corresponding supervisory guideline for industry consultation when the rules for reporting and related record keeping obligations are finalised.

Monitoring tools for intraday liquidity management

In March, the HKMA issued for industry consultation its proposals and draft reporting templates for local implementation of the Basel Committee guidance, *Monitoring Tools for Intraday Liquidity Management* (April 2013). The HKMA expects to finalise the reporting templates (taking into account industry comments) in the course of 2015. In light of the implementation approaches adopted by other supervisors and the time and resources required for AIs to adapt their reporting systems and data, there will be a grace period before reporting of intraday liquidity positions commences.

Other policy development work

Financial Sector Assessment Program (FSAP)

The FSAP team (led by the International Monetary Fund) conducted an assessment of the local financial sector in 2013 to assess the financial stability of Hong Kong. The report was published in July 2014[4]. Overall, the results were positive, with Hong Kong maintaining a very high level of compliance with the Basel Core Principles for Effective Banking Supervision. Of the 29 Core Principles, 26 were assessed as "compliant" while the remaining three were assessed as "largely compliant". Stress test results also suggested that AIs were well positioned to absorb any significant materialisation of risk.

[4] See Basel Core Principles for Effective Banking Supervision — Detailed Assessment of Observance, issued by the IMF, July 2014: http://www.imf.org/external/pubs/ft/scr/2014/cr14207.pdf

Accounting standards

Work on the convergence of accounting standards by the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) is nearing completion. However, on loan loss provisioning, while the two boards have developed respective new standards on the basis of expected credit losses, they are not fully converged in the treatment of performing loans and hence two different expected loss models will be implemented. The FSB will hold a round table in early 2015 for standard setters, supervisors and regulators, and other stakeholders to discuss how to promote further consistency of implementation of the two boards' accounting standards for financial instruments. Domestically, the HKMA has had initial discussions with bank auditors on AIs' plans for implementation of the new standard *IFRS 9 Financial Instruments* and the likely impact of the standard on AIs in general.

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 on the banking industry, and key domestic and international supervisory policy initiatives, including those related to banks' external auditors.

Recovery and resolution

As part of its package of policy measures to reduce the risks posed by systemically important financial institutions, the FSB issued the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes) in November 2011. In late 2014, the FSB reissued the Key Attributes with new annexes providing guidance on implementation in relation to information sharing for resolution purposes and on certain financial institutions operating in the non-bank sector as well as issuing a consultation on the recognition of cross-border resolution actions. All FSB member jurisdictions are expected to meet these international standards, in line with any supporting guidance, to ensure that both public authorities and financial institutions will be better placed to respond effectively to shocks that threaten the financial soundness of individual financial institutions, including financial market infrastructures, which could undermine the provision of critical financial services and the general stability and effective operation of the financial system.

The Hong Kong authorities have conducted an assessment of the extent to which existing intervention powers and arrangements meet the standards in the Key Attributes. It was identified that while a relatively well-developed statutory and regulatory framework is already in place, some significant gaps still exist. This assessment was confirmed by the FSB in a thematic peer review in 2013 as well as by the IMF which concluded that there was a strong case for reform after undertaking its own assessment of Hong Kong's crisis management arrangements as part of the FSAP in 2014. The HKMA, working with the FSTB, the SFC and the Insurance Authority (IA), contributed to a public consultation, issued by the FSTB in January 2014, on proposals for legislative reform to provide for a cross-sectoral resolution regime to address identified gaps in the existing framework against the standards set out in the Key Attributes. During the three-month consultation period, 33 formal responses were received, indicating broad support for the implementation of a resolution regime in Hong Kong meeting international standards. Following this first consultation, the authorities have developed their proposals and issued a second public consultation in January 2015 with further details on the bail-in resolution option; the governance arrangements and in particular the approach to designating resolution authorities; as well as safeguards including a 'no creditor worse off than in liquidation' compensation mechanism.

The Key Attributes also require jurisdictions to implement local recovery and resolution planning requirements covering, at a minimum, domestically incorporated financial institutions that could pose a threat to financial stability if they were to fail. Following consultations with the industry, the HKMA, in June 2014, issued an SPM module on "Recovery Planning" for AIs. The first wave of larger, more complex AIs submitted their first Recovery Plans in December 2014.

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 a member of a number of sub-groups under the Policy Development Group, including the Working Group on Capital, the Working Group on Liquidity, the Working Group on Disclosure, the Large Exposures Group, the QIS Working Group, the Task Force on Standardised Approaches, and the Task Force on Interest Rate Risk in the Banking Book. The HKMA is also a member of some sub-groups under the Supervision and Implementation Group, including the Working Group on SIB Supervision, the Colleges Working Group, the Task Force on Banking Book, and the Task Force on Impact and Accountability, and participates in the Basel Committee and International Organization of Securities Commissions' (IOSCO) Joint Working Group on Margining Requirements.

The HKMA is a member of the FSB Plenary Meeting, FSB Standing Committee on Supervisory and Regulatory Co-operation, and FSB Standing Committee 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 Supervisory Intensity and Effectiveness Group, the Compensation Monitoring Contact Group, and the Workstream on Other Shadow Banking Entities.

At the regional level, 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 (SEANZA). 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 being discussed at the Working Group's meetings.

International Conference of Banking Supervisors

The HKMA continues to actively participate in supervisory forums internationally. In September, the HKMA took part in the 18th International Conference of Banking Supervisors (ICBS) held in Tianjin, which was attended by 120 banking supervisors from over 90 jurisdictions and representatives from international financial institutions. The meeting was jointly organised by the China Banking Regulatory Commission (CBRC) and the Basel Committee. The ICBS' goal is to deepen the supervisory dialogue and co-operation on measures to strengthen the long-term resilience of the global financial system. The conference discussed a range of supervisory policies and measures relating to post-crisis reforms as well as the role of the banking system and financial services in supporting the real economy and promoting economic growth.

FSB Peer review of Germany

In the context of the FSB's peer review programme in 2013/2014, the HKMA led an international expert team which conducted a peer review of Germany. The team's final report was approved by the FSB and was published in April 2014. The expert team 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 in Germany, that were deemed most important and relevant to the FSB's core mandate of promoting financial stability.

Bank consumer protection

Code of Banking Practice

The industry's overall compliance with the Code of Banking Practice remained satisfactory. In the industry's annual self-assessment, covering the period from 1 January to 31 December 2013, all AIs reported full, or almost full, compliance[5]. The non-compliance issues reported mostly involved transparency and disclosure of information and the related policies and procedures. The

5 With five or fewer instances of non-compliance.

AIs concerned have taken steps to address the issues. The HKMA also conducted a thematic examination of one AI to review its compliance with the Code and related policies and controls.

The Code of Banking Practice Committee, on which the HKMA is represented, completed a comprehensive review of the Code in 2014. The revised Code will provide a wider protection to customers, promote good banking practices as well as enhance the provisions of the Code to align with international standards on financial consumer protection. Major enhancements to the Code, covering a wide range of banking products and services, include:

- extending the coverage of the Code to subsidiaries and affiliated companies controlled by AIs which are not licensed, regulated or supervised by other financial regulators;
- incorporating the *G20 High-level Principles on Financial Consumer Protection* as general principles in the Code;
- enhancing the disclosure and transparency about terms and conditions by AIs, which include the provision of new standardised Key Facts Statements by AIs setting out major terms and conditions of loan products to allow customers to easily access and compare details of such products, as well as explaining any revisions of terms and conditions of banking services;
- enhancing credit card related practices of AIs[6]; and
- providing more explanation on the customer due diligence requirements in relation to the opening of accounts, which would help members of the public to have a better understanding of the requirements and the basic types of documents which may be required of them for such purposes.

6 Enhancements include (i) to obtain the consent of the customers for upgrade and replacement of credit cards; (ii) to terminate non-activated cards after reminders for activation have been sent to the cardholders, hence non-activated cards will not be auto-renewed; and (iii) not to levy annual fees on non-activated cards.

The revised Code will become effective on 6 February 2015. AIs are expected to achieve full compliance with the new provisions as quickly as possible within six months of the effective date. Another six-month grace period is allowed for compliance with those provisions that require system changes by the AIs. The HKMA will monitor compliance as part of its ongoing supervision of AIs.

G20 High-level Principles on Financial Consumer Protection

The HKMA continued to participate in the Task Force on Financial Consumer Protection of the OECD to develop effective approaches to support the implementation of the *G20 High-level Principles on Financial Consumer Protection*. Following the publication of the effective approaches for three higher-priority principles in September 2013, the effective approaches for the remaining seven principles[7] were developed and endorsed at the G20 Summit in November 2014.

Treat Customers Fairly Charter

Following the launch of the Treat Customers Fairly Charter in October 2013, the HKMA, after consultation with the industry associations, issued a circular to all AIs in March 2014, providing a list of examples to assist them in developing a customer-centric culture that ensures customers are treated fairly and customers' interests are taken into account in everyday business decisions at all levels of AIs.

In support of the Charter principles, banks have exempted vulnerable customers and low-income customers from initial deposit requirements for opening accounts. This is in addition to the measures adopted in 2013 to abolish dormant account fees, waive low-balance fees for vulnerable customers and adopt a flexible approach to the charging of low-balance fees for low-income customers[8].

7 The remaining seven principles are: legal, regulatory and supervisory framework; role of oversight bodies; equitable and fair treatment of consumers; financial education and awareness; protection of consumer assets against fraud and misuse; protection of consumer data and privacy; and competition.

8 The flexible approach includes either treating the low-income customers as vulnerable customers and waive the low-balance fee or providing them with unlimited/limited free access to branch counter services in relation to their use of basic bank accounts which do not have a minimum balance requirement.

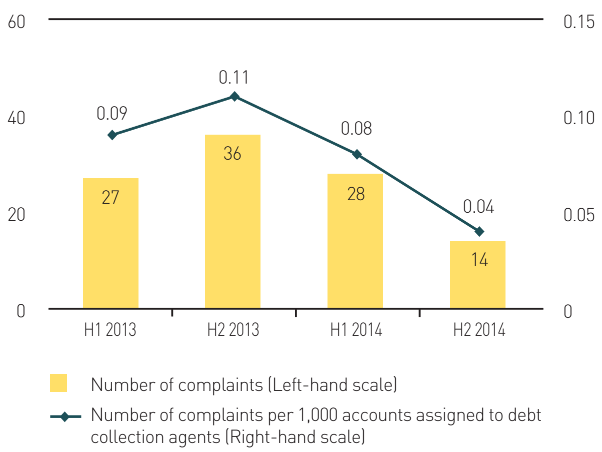
Credit data sharing

At the end of 2014, 116 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 125,600 business enterprises, about 17% 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 action 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 42 from 63 in 2013 (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**



Bank consumer education

The HKMA continued its Consumer Education Programme to educate the public to be smart and responsible in the use of banking services. One of the major initiatives was the launch of a series of short video clips to promote responsible credit card spending and security awareness when using self-banking services such as ATMs, the internet and mobile banking. To reach a wider audience, the videos were broadcast and promoted on the internet (such as the HKMA Smart Tips Channel on YouTube), smartphone apps, public transport, out-of-home and print media, the HKMA Information Centre and the Coin Carts.

Consumer education video promoting security awareness when using mobile banking.

Publicity for the video series on different platforms.

Thematic campaigns with smart tips publicised on radio, in the print media and on the internet were also used to promote public understanding of personal loans, as well as to remind bank customers to activate their new chip-based ATM cards. In addition, light-hearted audio clips promoting smart tips on different topics were broadcast on radio and smartphone apps.

「詩」人貸款錦囊

text | Li@UM art | Go 資料由客戶提供

一味靠估空餘恨　選擇貸款要謹慎

豬八戒情債篇

豬八戒：「多情自古空餘恨……」兩個都咁好，點揀呢？

看見綠信封降臨府上，就知道交稅季節又來啦！面對沉重的稅項，有人選擇借取私人貸款以作周轉。常見的有「分期貸款」及「循環貸款」兩類，大家知道它們有何分別嗎？

金姑娘：豬生！專一啲啦！啤！原來你揀緊銀行嘅「分期貸款」同「循環貸款」呀？俾個錦囊你！

「分期貸款」是按貸款金額計算全期利息，一般會以「每月平息」計算；借款人須按與銀行協定的模式，每月作等額還款。而「循環貸款」則按已動用的貸款金額逐日計算利息，借款人可隨時提取全部或部份貸款，及償還全部或部份欠款。每次還款後，可動用的信貸額會自動回升，讓借款人循環使用，銀行亦會定期檢討借款人的還款紀錄而調整貸款的利率或貸款額。大家在選擇私人貸款產品之前，必須清楚了解產品內容才作決定。

「零利息」背後的玄機

私人貸款產品常被標榜「零利息」或「全期免息」，但其實銀行可能會收取「手續費」或「服務費」等，所以不要以為「零利息」等於沒有任何借貸成本，或以為「每月平息」只得百分之零點幾，借貸成本就會很低。大家應參考「實際年利率」，因為它是把貸款利息加上各種費用而轉化成的一個參考年利率，能準確反映實際的借貸成本。

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Feature article on the issues to note in using personal loans.

Roving exhibitions were organised during the year to disseminate educational messages. The exhibitions included stage performance, information panels, game booths, an audio kiosk and photo booths. Educational leaflets and souvenirs were also distributed and post-event publicity was arranged in the print media to reinforce the messages.

Disseminating educational messages to the public through roving exhibitions.

Apart from organising talks and seminars for young people, the HKMA collaborated with stakeholders including the Investor Education Centre and St. James Settlement to promote responsible spending and enhance the financial literacy of students of tertiary institutions and senior secondary schools through various campaigns.

The HKMA also provided advice to the Investor Education Centre on educational materials published during the year to improve the public's understanding of insurance as part of financial planning and some important features about insurance products.

Enforcement

Banking complaints

The HKMA received 1,234 banking complaints (an increase of 10.7% compared with 2013) and completed the handling of 1,334 cases in 2014. At the end of the year, the total number of outstanding cases was reduced to 400 (Table 4).

Table 4 Banking complaints received by the HKMA

	2014			2013
	Conduct-related issues	General banking services	Total	Total
In progress on 1 January[Note]	253	247	**500**	1,313
Received during the year	151	1,083	**1,234**	1,115
Completed during the year	(244)	(1,090)	**(1,334)**	(1,928)
In progress on 31 December	160	240	**400**	500

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

Complaints relating to provision of banking services ranked highest in 2014, increasing by 127% to 175. The increase was mainly attributable to complaints about the termination of business relationships by AIs following customer due diligence processes and commercial decisions by some AIs to cease providing services related to a particular type of foreign exchange margin trading account. The number of complaints relating to insurance products increased by 25 % to 116, while complaints relating to ILAS products decreased by 14% to 38. Complaints regarding mis-selling of investment products declined by 20% to 47 and those related to credit card fees and charges by 23% to 48. Other major types of complaints included those related to credit card transactions (increased by 41% to 55), those related to client agreements (increased by 58% to 52) and complaints about ATM services (increased by 34% to 51).

During the year, the HKMA streamlined the operational workflow of its complaints handling process. As a result, around 60% of the general banking services complaints received were handled within three months, of which more than half were completed within two months. The complainants in around 75% of cases involving general banking services were satisfied after receiving the banks' final reply.

Enforcement actions

HIBOR fixing

In March, the HKMA announced the outcome of its investigation into the Hong Kong Interbank Offered Rate (HIBOR) fixing of nine HIBOR reference banks. The HKMA found evidence of misconduct in the submission of HIBOR rates by UBS AG (UBS), but no evidence of collusion among the nine banks to rig the HIBOR fixing. The HKMA investigation also found that UBS had failed to report the misconduct of its staff to the HKMA, and there were material weaknesses in UBS's internal controls and governance in managing the HIBOR submission process and in other areas. UBS was required to take appropriate disciplinary actions against the individual staff members concerned, implement a remedial plan for the weaknesses identified, and engage an independent reviewer to assess the effectiveness of the remedial measures following implementation.

Emerging Markets Rates business

In April, the HKMA announced its findings against The Royal Bank of Scotland plc (RBS) concerning internal control failures in detecting and preventing unauthorised trading activities in its Emerging Markets Rates business in Hong Kong from May 2008 to October 2011, in conjunction with the disciplinary action taken by the SFC. As a result of the HKMA's investigation, RBS was required to implement corrective measures and take appropriate action against staff who failed to adequately perform their duties or otherwise bore responsibility for the failures identified. Pursuant to section 59(2) of the Banking Ordinance, RBS was also required to appoint an external auditor to conduct an independent review on the effectiveness of its corrective measures and report the results to the HKMA.

Foreign exchange trading operations

In December 2014, the HKMA announced the outcome of its investigation into the foreign exchange (FX) trading operations of 10 banks in Hong Kong. The HKMA investigation found no evidence of collusion among the banks investigated and no evidence of any rigging of FX benchmark fixings in Hong Kong or in other jurisdictions except for a case of suspected attempt to influence an Asian currency benchmark fixing. As regards FX trading, the investigation discovered one case involving a failed attempt by a Hong Kong-based trader to influence the USD/HKD spot rate at the request of a colleague in another Asian jurisdiction. The investigation also identified certain control deficiencies resulting in some isolated cases of communication indiscretions. Possible information that may relate to counterparties or clients was disclosed to other banks. But no evidence of market manipulation was found. The HKMA took actions against the banks and their staff concerned according to the severity of the inappropriate conduct or weaknesses found.

Others

During the year, disciplinary sanctions, ranging from suspension to life ban, were imposed by the SFC on eight former relevant individuals following referral by the HKMA. The HKMA issued 41 compliance advice letters to AIs and their staff that were found not acting in full compliance with the relevant regulatory requirements, but whose lapses did not warrant disciplinary sanctions.

Complaints Watch

As part of the HKMA's initiatives to promote proper standards of conduct and prudent business practices among AIs, a periodic newsletter *Complaints Watch* was introduced in May to share with the banking industry information on latest complaint trends and emerging topical issues. Topics covered in the 2014 newsletters included complaints relating to insurance products, merchant name displays on credit card statements, resumed debt collection after a long period of non-action, terminating services due to business strategy changes, unauthorised transactions, and remittance frauds.

Deposit Protection

The Deposit Protection Scheme (DPS) continued to offer protection to deposits up to $500,000 per depositor per bank. The DPS was reviewed by the IMF as part of the FSAP review of the crisis management framework in Hong Kong. The review covered the functioning of the DPS in contributing to financial stability with reference to international principles. The IMF concluded in its report of May 2014 that the DPS in Hong Kong contained many good features, and that it was transparent and trusted. It recommended that Hong Kong should consider further enhancing payout efficiency and conduct a review of the funding modalities.

The IMF's recommendations were incorporated into an enhancement plan for achieving prompt payout, which was issued for public consultation in September. The main proposal is for the adoption of gross payout (as opposed to the current requirement of setting off customer liabilities against protected deposits when determining DPS compensation) and other technical enhancements. The submissions received during the consultation were supportive of the proposals.

Other initiatives undertaken in 2014 to enhance payout efficiency included an upgrade of the payout infrastructure and system, development of more sophisticated pre-payout preparatory procedures, and the identification of electronic payment channels for supporting faster payout. The sustainability of the DPS Fund was reviewed during the year and it was concluded that no change to the existing funding structure was required.

The monitoring of compliance with the requirements in relation to representation about DPS protection by member banks to the Scheme (Scheme members) was conducted through annual self-assessments by Scheme members and on-site examinations by the HKMA. The compliance of Scheme members was generally satisfactory. Good progress was made by Scheme members in preparing to meet the revised requirements on submission of deposit records issued in September 2013.

Continuous publicity and community education campaigns were undertaken to promote the DPS to the general public and targeted groups. The general awareness of the DPS remained at a high level of 78%.

Oversight of financial market infrastructures

The HKMA issued a policy statement in 2013 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, limit systemic risk and foster transparency. The aim is to make the FMIs more resilient to financial crises and protect the monetary and financial systems in Hong Kong from possible destabilising effects arising from disruption to the FMIs. The policy statement, which is available on the HKMA website, is updated from time to time to reflect changes to the oversight framework.

The Clearing and Settlement Systems Ordinance (CSSO) 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), the Hong Kong dollar Clearing House Automated Transfer System (HKD CHATS), the US dollar CHATS, the Euro CHATS, the Renminbi CHATS and the Continuous Linked Settlement (CLS) System. The HKMA is also responsible for overseeing the OTC Derivatives Trade Repository (HKTR), which is owned and operated by the HKMA. Since it is not a clearing or settlement system, it is not designated as such under the CSSO. 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 designated systems under its purview. All the designated systems and the HKTR are treated as FMIs in Hong Kong.

The HKMA continued to incorporate international standards into its oversight framework of FMIs. The Committee on Payments and Market Infrastructures (CPMI) 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 constitute 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. The HKMA and SFC jointly issued a policy statement in March 2013 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 2013, an amended statutory "Guideline on the Oversight Framework for Designated Systems" under the CSSO and, in July 2013, a new "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 the FMIs under its purview to ensure observance of the PFMI, including requesting them to make necessary changes in specific areas to conform to the relevant requirements, and be generally observant of the PFMI by 31 December 2015.

International participation

The HKMA is a member of the CPMI and participates in meetings, working groups and forums on FMI oversight matters. It also participates in the CPMI-IOSCO Implementation Monitoring Standing Group, which is responsible for monitoring and assessing the implementation of the PFMI by different jurisdictions. In addition to participating in the monitoring and assessment of other jurisdictions, the HKMA is also one of the parties being assessed. The Level 1 assessment, which reviewed whether jurisdictions had completed the process of adopting legislation and policies to implement the PFMI, concluded that the HKMA had adopted the PFMI within its oversight framework.

The HKMA is also a member of the Oversight Forum of the global message carrier SWIFT (the Society for Worldwide Interbank Financial Telecommunication), which discusses relevant oversight matters and shares SWIFT-related information. Hong Kong's AIs and FMIs use, and rely on SWIFT's services and may be exposed to risks in the event of any disruption to its operations.

The HKMA 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 operational and development matters as well as Hong Kong dollar-specific issues to ensure the System continued to meet the safety and efficiency requirements under the CSSO.

In addition to the CLS System, the HKMA held discussions with relevant overseas authorities to further strengthen the co-operative oversight of links between the FMIs in Hong Kong and those overseas. In particular, the HKMA discussed strengthening the existing co-operative oversight arrangements for the PvP links between USD CHATS and the Malaysian ringgit, Indonesian rupiah, and Thai baht RTGS systems. The HKMA also strengthened the co-operative oversight of links between the CMU and overseas systems.

In October, the HKMA entered into a Memorandum of Understanding with the National Bank of Belgium on the "Co-operation and communication framework regarding the co-operative oversight of the Hong Kong Financial Market Infrastructure-Euroclear Bank linkages". Appropriate co-operative oversight arrangements will be established with other overseas regulators as required.

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 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 2014 and reviewed four regular reports and 23 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 2014, 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 2014, 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 and Director Development Programme

At the end of 2014, Hong Kong had 159 licensed banks, 21 restricted licence banks, 23 deposit-taking companies and 16 approved money brokers. During the year, the HKMA granted two banking licences to two foreign banks, one restricted banking licence to a local subsidiary of a foreign banking group, upgraded a foreign-incorporated restricted licence bank to a licensed bank, and approved one money broker incorporated outside Hong Kong. One restricted licence bank (the one which was upgraded to a licensed bank) and one deposit-taking company revoked their authorization during the year.

The Advisory Group on Skills and Knowledge Development for Bank Directors, led by the HKMA, held its inaugural meeting in January 2014 to advise on the topics and types of activity that should be included in the induction training and continuing development programmes for directors of locally-incorporated AIs. In this context, the HKMA worked with the Hong Kong Institute of Bankers (HKIB) during the year to develop induction and continuing development programmes for directors. In view of the positive response to the introductory-level Corporate Governance programme held in 2013, the HKIB repeated the programme to provide an opportunity for more directors to participate. The HKIB also organised a topical seminar on anti-money laundering standards and another on digital trends and cyber security. The seminars provided a useful channel for keeping directors up to date with developments in regulatory requirements and emerging risks facing the industry.

In 2014 the HKMA organised two experience-sharing sessions for recently appointed independent non-executive directors (INEDs) of locally-incorporated AIs. These were informal small group sessions aimed at providing an opportunity for participants to share their experiences and any challenges they encountered when undertaking their duties as INEDs. The sessions provide a candid insight into how INEDs approach their roles and their views on requirements for training and other support.

Deputy Chief Executive of the HKMA, Mr Arthur Yuen, speaks at the press conference on 2013 Year-End Review and Priorities for 2014 for the Hong Kong Banking Sector on 24 January 2014.

PLANS FOR 2015 AND BEYOND

Supervisory focus

Credit growth and asset quality

Because of the uncertain global economic conditions and the possible adverse impact of interest rate normalisation on asset prices and loan quality, the HKMA will continue to closely monitor the asset quality of AIs' lending portfolios, and ensure that Hong Kong's banking system is resilient to the potential downturn in the credit cycle.

Mainland-related business

Proactive steps will again be taken to promote prudent credit underwriting and risk management practices for Mainland-related lending activities. In addition to on-site examinations and off-site analyses of the effectiveness of AIs' risk management systems for Mainland-related lending business, the HKMA will closely monitor AIs' progress in enhancing their systems for identifying emerging risks and detecting early signs of deterioration in asset quality.

Prevention of money laundering and terrorist financing

The HKMA will work with the Government and the industry to step up money laundering and terrorist financing risk assessments at all levels, which will help determine changes that may be required to Hong Kong's AML/CFT legal and regulatory regime.

The strengthened programme of AML/CFT examinations will continue while a collaborative partnership with the industry will be maintained to develop further guidance in key areas.

Risk governance

The HKMA will continue to participate in various board or board-level committee meetings of local retail banks to evaluate the risk governance standards and identify room for improvement. Local retail banks have been requested to revise their risk governance frameworks and risk appetite statements in 2015 to bring them in line with the FSB standards and market practices. The HKMA will also conduct interviews with the chief risk officers of local retail banks to cultivate a stronger sense of risk governance, and a more structured approach will be developed to raise the risk governance of AIs.

Supervision of treasury activities and liquidity risk

The HKMA will continue to conduct on-site examinations of AIs' treasury and derivative activities. Given the implementation of the new liquidity regime in Hong Kong, the HKMA will monitor the industry's implementation of the requirements to aim for AIs' full compliance.

Supervision of operational and technology risks

The SPM module in relation to the risk management of e-banking will be further updated in consultation with the banking industry. Policy guidance on other aspects of operational or technology risk management will be issued as necessary, including the periodic "Operational Incidents Watch" for sharing the operating method or control weaknesses related to significant fraud cases or operational incidents. The HKMA will also work with the banking industry and other stakeholders to step up efforts in raising public awareness of security precautions when using electronic banking services.

A combination of risk-focused on-site examinations, and off-site surveillance and supervisory activities will be used to identify trends in operational and technology risks in the industry and the status of AIs' risk management controls. The emphasis will be on the responsibilities of AIs' boards and senior management in overseeing and managing operational and technology risks, particularly AIs that are more important to the stability and effective functioning of the monetary and banking systems of Hong Kong.

Supervision of wealth management 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 that the HKMA expects institutions to observe in the sale of investment products;
- monitor AIs' implementation of the enhanced regulatory requirements and expected practices in selling insurance products;
- continue to provide advice to the private wealth management industry and the training institutes in implementing the ECF, and monitor private banking practitioners' efforts in adopting the framework;
- continue to co-operate with the FSTB in the legislative process of establishing an independent Insurance Authority and a statutory licensing regime for insurance intermediaries; and
- continue to conduct on-site examinations and off-site surveillance of AIs' conduct in the selling of securities, MPF and other investment and insurance products, including high-yield bond products and renminbi structured products.

Basel III

Capital standards

Alignment revisions arising from RCAP

Based on the findings of the Basel Committee's Regulatory Consistency Assessment Programme (RCAP) assessment on Hong Kong, the HKMA will propose amendments to the Banking (Capital) Rules (BCR) to more closely align certain provisions with the Basel capital standards, after taking into account the circumstances of the local banking sector. Industry consultation is expected to commence in the first half of 2015.

Equity investments in funds and counterparty credit risk

The Basel Committee issued three sets of final standards in 2013 and 2014: *Capital requirements for banks' equity investments in funds* (December 2013); *The standardised approach for measuring counterparty credit risk exposures* (March 2014) (revised in April 2014); and *Capital requirements for bank exposures to central counterparties* (April 2014). The first two are new standards while the last introduces revisions to the interim capital requirements issued by the Basel Committee in July 2012. All of these final standards are scheduled to come into effect on 1 January 2017. The HKMA intends to implement the final standards in accordance with the Basel Committee's timetable. Policy proposals for amendments to the BCR will be issued for industry consultation in 2015.

Disclosure standards

Under the Basel Committee's Basel III transition timetable, banks are required to make disclosures in relation to the Basel III leverage ratio, capital buffers (where applicable) and LCR starting from 1 January 2015. To facilitate the consistency and comparability of disclosures among AIs, the HKMA will issue a set of standard disclosure templates within the first half of 2015 (based on those prescribed by the Basel Committee) for AIs to make disclosures under the BDR as amended by the BDAR 2014. The HKMA will monitor AIs' disclosures to ensure they are compliant with the Basel Committee's requirements.

In the first half of 2015, the HKMA will issue for industry consultation a revised version of the "Guideline on the Application of the Banking (Disclosure) Rules" in the SPM, to update the interpretative guidance to facilitate AIs' disclosures under the BDR in the light of both the Basel III implementation and recent changes in regulatory reporting.

The HKMA also intends to consult the industry in 2015 on policy proposals for implementing the revised Pillar 3 disclosure requirements, issued by the Basel Committee in January 2015. Implementation will require amending the BDR, supplemented with the issuance of standard disclosure templates (based on those prescribed in the revised requirements by the Basel Committee) designed to facilitate consistency and comparability of disclosures among banks and across jurisdictions.

Basel III (continued)

Supplementary guidance for Basel III implementation

Following the implementation on 1 January 2015 of the provisions in the BCAR 2014 relating to the CCyB, the HKMA will —

(a) issue the final versions of the SPM modules on "Countercyclical Capital Buffer (CCyB) — Approach to its Implementation" and "Countercyclical Capital Buffer (CCyB) — Geographic Allocation of Private Sector Credit Exposures" after incorporating feedback from the industry; and

(b) after assessing prevailing macroprudential conditions and the extent of systemic risk build-up in Hong Kong, announce a CCyB rate applicable to private sector credit exposures in Hong Kong, which will take effect in early 2016, thus giving the banking industry one year advance notice to adjust their capital planning.

Liquidity standards

In 2015, the HKMA will focus on monitoring the implementation of the new LCR and LMR liquidity standards and completing associated work to enhance the local liquidity risk regulatory regime, including:

(a) revision of the existing statutory guideline on "Liquidity Risk Management" (SPM LM-1) to provide supplementary guidance on the application of LCR and LMR requirements under the BLR and related Code of Practice. The relevant guidance relates, for example, to the operation of the two-tiered approach to designating category 1 and category 2 institutions; and provides further elaboration on the qualifying criteria for certain types of assets that may be recognised as HQLA under the LCR (or liquefiable assets under the LMR), and on the identification of certain types of liabilities (such as operational deposits) that may be subject to more preferential treatment under the LCR;

(b) expansion of the existing liquidity reporting framework to support the reporting by AIs of information relating to the liquidity monitoring tools introduced by the Basel Committee to supplement the LCR and the NSFR. For this purpose, a new return on Liquidity Monitoring Tools (Form MA(BS)23) will be introduced in the course of 2015 taking into account the results of industry consultation conducted in 2014; and

(c) development of policy proposals for the local implementation of the NSFR in consultation with the industry, taking into account the steps likely to be adopted by major overseas regulators.

In addition to the revision of the guidance relating to liquidity risk under the SPM, the approach to supervising AIs' management of their liquidity risk will also be updated under the enhanced liquidity regime.

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

SIFI framework

With the commencement on 1 January 2015 of the provisions in the BCAR 2014 relating to the designation of D-SIBs and the finalisation of the SPM module "Systemically Important Banks", the HKMA has initiated its assessment process and announced a list of D-SIBs (and their corresponding HLA capital requirements) in March 2015. The phased-in HLA capital requirements can then begin to apply to such D-SIBs starting in 2016. At present, there are no locally incorporated AIs meeting the criteria for designation as G-SIBs.

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. AIs are expected to continually enhance their stress testing capability taking into account, among other things, the experience gained in the supervisor-driven stress testing programme and to better integrate their stress testing into the capital planning processes. The HKMA will continue to review the stress testing processes and capabilities through on-site visits and off-site reviews.

Co-operation with overseas supervisors

Key priorities will be to work with the crisis management groups of the internationally active banks on formulating recovery and resolution strategies and plans, and completing resolvability assessments in accordance with the timetable set by the FSB. The HKMA will seek to ensure the timely sharing of bank-specific information on prudential and other matters, including the latest developments on liquidity and solvency positions, with the overseas supervisors. With the creation of the Single Supervisory Mechanism in Europe in 2014, the HKMA aims to develop a close working relationship with the European Central Bank in its new capacity.

Recovery and resolution

The HKMA will continue to work closely with the FSTB, the SFC and the IA on proposals to establish a cross-sectoral resolution regime for financial institutions in Hong Kong. After considering submissions received in response to the second public consultation exercise, and taking into account any further developments at the international level including any guidance on recognition of cross-border resolution actions, the proposals will be further refined with a view to introducing a Bill into the Legislative Council by end-2015.

Following on from the SPM module on "Recovery Planning" issued in June 2014, a new SPM module on "Resolution Planning" is expected to be issued during 2015, following consultation with the industry. The HKMA will also continue its involvement in crisis management groups for a number of G-SIBs with sizeable operations in Hong Kong, where work is underway to develop firm-specific group-level recovery and resolution plans.

Securitisation standards

In December 2014, the Basel Committee issued *Revisions to the securitisation framework* to introduce a revised hierarchy of approaches and enhanced requirements for the calculation of regulatory capital on exposures to securitisations. The HKMA will assess the policy implications on the local securitisation framework during 2015.

Accounting standards

International regulatory developments in accounting standards will be monitored by the HKMA, including at the FSB and the Basel Committee, on the implementation of the new standard *IFRS 9* financial instruments by banks. It will also maintain contact with the HKICPA and the banking industry on the implementation of the new accounting standard on loan loss provisioning and its impact.

Development of Supervisory Policies

Credit risk transfer

The HKMA is developing a supervisory guideline to strengthen its guidance on AIs' credit risk transfer activities reflecting, among other things, international developments in the regulation of securitisations (such as disclosure requirements and measures to align incentives between originators and investors) and the reduction of reliance on external credit ratings (such as more stringent requirements for banks' internal credit assessment of securitisation exposures).

Counterparty credit risk

The SPM module "Counterparty Credit Risk Management" will be updated and brought into line with the latest capital treatment for counterparty credit risk (CCR) under the BCR. It will take into account the new standardised approach for measuring CCR introduced by the Basel Committee, as well as recent developments in CCR management practices following the global financial crisis.

Corporate governance

The FSB issued a set of *Principles for an Effective Risk Appetite Framework* and *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture* in November 2013 and April 2014 respectively to promote sound risk governance at financial institutions. In October 2014, the Basel Committee issued a consultative document on the revision of its *Principles for enhancing corporate governance*. The HKMA will revise the SPM module on "Corporate Governance of Locally Incorporated Authorized Institutions" to reflect these new international standards.

Total loss-absorbing capacity

In November 2014, the FSB published a consultative document on the *Adequacy of loss-absorbing capacity of global systemically important banks in resolution* in response to a call by the G20 to enhance the loss-absorbing capacity of G-SIBs in resolution. The proposals include a set of principles on the total loss-absorbing capacity (TLAC) and the recapitalisation capacity of G-SIBs in resolution, as well as a term sheet setting out a concrete proposal for implementing these principles. The HKMA will monitor developments, particularly the proposals on internal TLAC, as some AIs in Hong Kong are part of G-SIB groups.

Sound systems and controls for liquidity risk management

The HKMA intends to update the statutory guideline "Sound Systems and Controls for Liquidity Risk Management" (LM-2) in the SPM, taking into account the final form of the LCR, international developments on liquidity risk management standards, and the experience gained so far in implementing LM-2. This reflects the HKMA's strong emphasis on the development of prudent risk management systems by AIs to enhance their liquidity resilience.

Internal audit and compliance functions

The HKMA has revised the supervisory guideline "Internal Audit Function" in the SPM to incorporate the latest guidance on *The Internal Audit Function in Banks* issued by the Basel Committee in June 2012. The main areas of revision 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. The revised guideline will be issued for industry consultation during 2015. Consideration will also be given to introducing a separate supervisory guideline on the attributes of an effective compliance function.

Development of Supervisory Policies (continued)

Large exposures

Following the release of the Basel Committee's enhanced large exposures regime in April 2014, the HKMA has been assessing the policy implications for the local regime. Under the new Basel standards, most exposures to single or connected counterparties will be subject to a 25% Tier 1 capital limit. A stricter 15% limit applies to exposures between G-SIBs, while intra-group exposures and exposures to sovereigns are exempted from the framework. The HKMA expects to begin consulting the industry on its proposals for local implementation of the revised standards during 2015.

To facilitate more effective monitoring of concentration risk in the form of large exposures and to prepare for the implementation of the Basel Committee's revised large exposure regime, the HKMA has developed revisions to the regulatory Return of Large Exposures. The proposed changes will require the reporting of counterparty credit risk exposures arising from foreign exchange, interest rate and other derivatives contracts. Industry consultation on the proposal was conducted in January 2015.

Guideline on OTC derivatives market reforms

Supervisory guidelines to support the phased implementation of the new regulatory framework for the OTC derivatives market in Hong Kong are being developed by the HKMA. The focus in 2015 will be on the provision of guidance for the application of mandatory clearing and related record keeping obligations, as well as of the Basel Committee/IOSCO margin requirements and IOSCO's risk mitigation standards for non-centrally cleared derivatives.

Guideline on the Supervisory Review Process

The HKMA intends to revise the scorecard relating to liquidity risk used in its SRP to accommodate the implementation of the new liquidity regime. It will also take the opportunity to update the guideline on the "Supervisory Review Process" more generally to incorporate the latest international standards, including those on capital planning processes set out in *A Sound Capital Planning Process: Fundamental Elements*, issued by the Basel Committee in January 2014.

External audits of banks

In March 2014, the Basel Committee issued revised supervisory guidance on the *External audits of banks*. The guidance aims to improve audit quality by raising the bar in relation to what supervisors expect from banks' external auditors and audit committees. The HKMA will issue updated supervisory guidance for AIs that will reflect the new international standard.

Other risk management guidance

In 2015, the HKMA expects to develop and consult the industry on a range of guidance in other areas of risk management to better align with international best practices and relevant publications issued by the Basel Committee, including market risk management and connected lending.

International co-operation

The HKMA will maintain its active involvement in the work of the Basel Committee and the FSB. This will include thematic peer reviews on resolution regimes and on other shadow banking entities which are expected to be undertaken by the FSB in 2015.

Bank consumer protection

The HKMA will continue to promote good banking practices through participation and providing advice to the Code of Banking Practice Committee. It will monitor AIs' implementation of the revised Code with a progress survey in 2015 and will review AIs' compliance with the Code through on-site examinations and handling complaints about products and services provided by AIs.

The HKMA will monitor how the banking industry adopts specific measures to implement the Treat Customers Fairly principles in 2015. The HKMA will also consider how the effective approaches promulgated by the OECD Task Force on Financial Consumer Protection to support the implementation of the *G20 High-Level Principles on Financial Consumer Protection* can be appropriately implemented in Hong Kong.

Bank consumer education

Further initiatives will be launched under the HKMA's Consumer Education Programme, including the production of a drama series, radio broadcasts and outreach activities, to encourage the public to be smart and responsible in the use of banking services. New campaigns targeting students of tertiary institutions and secondary schools will be introduced to promote financial literacy and responsible spending. In addition, the HKMA will continue to collaborate with other stakeholders to maximise the benefits of consumer education.

Credit data sharing

The HKMA will work with the industry to promote credit data sharing, as its continued development will help strengthen the credit risk management capacity of AIs.

Enforcement

More resources will be deployed to the HKMA's enforcement functions under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance. This will also involve monitoring trends related to complaints received and, where appropriate, taking prompt action to contain or mitigate potential problems.

Deposit protection

The HKMA will provide continuing support to the Hong Kong Deposit Protection Board for maintaining an effective and efficient DPS. Taking into account the IMF review and its May 2014 report on the functioning of the DPS, and the comments received in the public consultation on DPS enhancements, the conclusions of the final policy proposals will be issued, and the required legislative amendments will be prepared to implement the proposals to achieve a fast payout.

With the revised requirements on the submission of deposit records coming into force in 2015, a new independent assessment programme will be introduced to ensure that Scheme members are ready to provide the required information within the specified timeframe in accordance with the enhanced requirements. Payout simulations and a rehearsal exercise will be conducted to verify the enhanced systems and processes, as well as to ensure the HKDPB, supported by its network of service providers, is ready to make compensation to depositors swiftly in case of a bank failure. To monitor compliance with the DPS representation requirements, annual self-assessments and on-site examinations will continue. Publicity will be arranged to reinforce the public's understanding of and confidence in the protection available under the DPS.

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 codes of practice.

It will work with the FMIs on their observance of the PFMI. Assessments will be conducted, and the HKMA will continue participating in the CPMI-IOSCO PFMI implementation monitoring and assessment exercise. Where appropriate, oversight requirements will be enhanced to reflect international practices or in response to market developments.

Director Development Programme

The HKMA is committed to working with the industry to support the skills and knowledge development of directors of AIs. It will monitor international developments in corporate governance practices for banks, including any recommendation by international standard-setting bodies in relation to Board qualifications, to further enhance the director development programme and, in due course, draw up best practice guidance on this subject.