Banking Stability

The HKMA focused its supervisory efforts on authorized institutions' risk governance, including credit and liquidity risk management systems, anti-money laundering and counter-terrorist financing controls, and selling practices for investment and insurance products. With the build-up of systemic risks, the HKMA announced a 0.625% jurisdictional Countercyclical Capital Buffer for Hong Kong from 1 January 2016 (and 1.25% from 1 January 2017). Five authorized institutions were designated as Domestic Systemically Important Banks which will be subject to a Higher Loss Absorbency capital buffer. Significant progress was made on reforms for recovery and resolution with the introduction of the Financial Institutions (Resolution) Bill into the Legislative Council. The HKMA also stepped up its work with the banking industry on enhancing access to basic banking services, consumer education, and the skills and knowledge development of bank directors and financial practitioners.

REVIEW OF 2015

Overview

Amid signs of a divergence in monetary policy stances among the major developed economies, emerging markets faced a higher risk of capital outflows and slower economic growth in 2015. In order to maintain the resilience of the banking sector against a possible abrupt deterioration in the macroeconomic environment, the HKMA continued to closely monitor the effectiveness of authorized institutions' (AIs) risk governance and their systems for management of credit and liquidity risks.

Operational supervision

In 2015, the HKMA continued to adopt the supervisory approach where regular on-site examinations were supplemented by an increased number of thematic reviews. Thematic reviews are in-depth off-site reviews focusing on particular risk areas or specific activities of groups of selected AIs. This approach has allowed the HKMA to prioritise its supervisory resources to focus on emerging and more significant risks of AIs.

During the year, the HKMA performed a total of 193 on-site examinations. More in-depth thematic on-site examinations on credit risk management and asset quality were conducted, in view of the emerging signs of deterioration in the asset quality of AIs' loan portfolio. The HKMA increased the number of examinations on treasury related activities given market uncertainty amid the divergence of monetary policies in major advanced economies. On-site examinations were also conducted on Mainland-related business, stress testing and liquidity risk management, operational and technology risk management, capital planning, anti-money laundering and counter-terrorist financing (AML/CFT) controls and internal ratings-based (IRB) models of AIs. AIs' activities in securities, investment products, insurance and Mandatory Provident Fund (MPF)-related businesses were also subject to on-site examinations by specialist teams during the year.

Furthermore, a total of 152 thematic off-site reviews were conducted covering similar areas as the thematic on-site examinations. Table 1 contains details of the operational supervision work.

In 2015, 196 off-site reviews were conducted to assess AIs' corporate governance, financial position and business operations. Supervisory attention focused on risk governance, capital planning, corporate sector credit and monitoring of implementation of Basel III standards. The supervisory teams maintained frequent contact with the boards of directors and external auditors of selected AIs. 20 tripartite meetings were held with the senior management and external auditors of AIs, while 23 meetings were held with the full board or board-level committees of selected AIs.

The Banking Supervision Review Committee considered four cases, all concerning the authorization of AIs.

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 2015. Two of the reports covered AML/CFT controls and another two of the reports covered private banking business, while the remaining were related to areas including securities related activities and loans classification system.

No AI breached the requirements of the Banking Ordinance relating to capital adequacy or liquidity ratio in 2015. There were 84 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

		2015	2014
1	On-site examinations	**193**	216
	Reviews of the internal ratings-based (IRB) approach	**2**	3
	Capital planning	**6**	3
	Market risk, counterparty credit risk and treasury activities	**23**	12
	Stress testing and liquidity risk management	**2**	13
	Securities, investment products, insurance and MPF-related businesses	**22**	20
	Deposit Protection Scheme-related representation	**12**	13
	Code of Banking Practice/Consumer Protection	**1**	3
	AML/CFT controls	**21**	19
	IT, Internet banking and operational risk	**27**	45
	Mainland-related business and renminbi business	**22**	61
	Credit controls, credit risk management and asset quality	**49**	16
	Overseas examinations	**6**	8
2	Thematic reviews	**152**	127
	Reviews of the IRB approach and stress testing	**7**	12
	Treasury activities	**–**	36
	AML/CFT controls	**22**	15
	IT, Internet banking and operational risk	**45**	29
	Credit risk management and controls	**69**	35
	New product reviews	**6**	–
	Selling of investment products	**3**	–
3	Off-site reviews and prudential interviews	**196**	197
4	Tripartite meetings	**20**	22
5	Meetings with board of directors or board-level committees of AIs	**23**	15
6	Approval of applications to become controllers, directors, chief executives or alternate chief executives of AIs	**291**	299
7	Reports commissioned under section 59(2) of the Banking Ordinance	**6**	6
8	Cases considered by the Banking Supervision Review Committee	**4**	5
9	AIs subject to the exercise of powers under section 52 of the Banking Ordinance	**1**	1
10	Reports commissioned under section 21(2)(b) of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance	**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. There was no request for a review during the year.

Specialised supervisory work

Supervision of operational and technology risks

The HKMA continued to issue new or updated guidance on operational and technology risk management in the light of emerging risks and industry developments. In particular, the HKMA completed the revision of the Supervisory Policy Manual (SPM) module in relation to electronic banking (e-banking), which allows AIs more flexibility in offering new e-banking services. In addition, a circular was issued on cyber security, reiterating the importance for the boards and senior management of AIs to have oversight of effective cyber security risk management. The HKMA also published periodic issues of its "*Operational Incidents Watch*" highlighting the modus operandi of selected fraud cases or operational incidents and the control weaknesses identified.

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

The HKMA conducted risk-based thematic on-site and off-site supervisory reviews to evaluate selected AIs' operational and technology risk management at the enterprise level or in specific business lines. These covered selected areas in relation to AIs' operational risk management framework, cyber security risk management, controls for guarding against rogue trading activities, oversight of important outsourcing service providers, fraud risk management and technology controls for anti-money laundering. These supervisory reviews were supplemented by the annual independent compliance exercises covering operational risk management framework, technology risk management (including protection of customer data) and business continuity planning, where selected AIs were required to appoint independent and qualified assessors to examine the adequacy of their relevant controls and then rectify the weaknesses identified. The HKMA also identified and analysed the trend and key supervisory focus of AIs' operational and technology risks, with particular reference to the AIs that play an important role in the stability and effective functioning of Hong Kong's monetary and banking systems.

The HKMA monitored the final phase of the banking industry's implementation of the chip-based ATM technology through which AIs completed the card replacement process of pure credit cards by the end of 2015. The HKMA also required card issuing AIs to implement authentication controls to further improve the security over "card-not-present" credit card transactions. Separately, after receiving reports that the names of cardholders stored in some contactless credit cards could be accessed stealthily, the HKMA required the AIs concerned to take prompt action to notify and protect the affected cardholders. The HKMA devoted resources to publicise and explain the scale and implications of the incident to address public concern and to monitor AIs' remedial efforts, including the prompt replacement of affected cards.

The HKMA collaborated with the industry and other stakeholders on a number of initiatives, including public awareness programme on e-banking security precautions, establishing a platform for sharing cyber security intelligence, and providing support and advice to a crisis management exercise organised by the Hong Kong Financial Services Business Continuity Management Forum that involved AIs and other financial firms.

Supervision of wealth management and MPF-related businesses

The HKMA co-operated closely with other financial regulators in Hong Kong in providing guidance and supervising AIs' selling of securities, investment products, insurance products and MPF schemes. Regular contact was maintained with the regulators through bilateral and multilateral meetings, as well as under the auspices of the Council of Financial Regulators. These meetings covered various issues involving financial groups or regulated entities with close business relationships across different sectors in the financial services industry to ensure more co-ordinated and effective supervisory action.

During the year, the HKMA conducted 25 on-site and off-site thematic examinations and 15 off-site surveillance of AIs. These covered 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 involving retail, private banking and corporate banking customers.

In August, the HKMA issued a circular to AIs to provide guidance on suitability assessment and product information disclosure in the selling of NLTI products to customers. The guidance aimed to assist AIs in complying with regulatory standards, including relevant requirements issued in July by the Office of the Commissioner of Insurance and the Hong Kong Federation of Insurers.

The HKMA continued to work closely with the Financial Services and the Treasury Bureau (FSTB) in the legislative process for the Insurance Companies (Amendment) Bill 2014, to establish an independent Insurance Authority and a statutory licensing regime for insurance intermediaries. In July, the Insurance Companies (Amendment) Ordinance 2015 was enacted by the Legislative Council, which provides, among other things, for the inspection and investigation powers, in respect of AIs' insurance intermediary activities, of the Monetary Authority through delegation.

The HKMA processed six applications to become Registered Institutions (RIs) and one application from RIs to engage in additional regulated activities. It granted consent to 204 executive officers responsible for supervising the securities activities of RIs, and conducted background checks on 9,697 individuals whose information was submitted by RIs for inclusion in the register maintained by the HKMA.

Supervision of treasury activities

AIs' liquidity risk management remained one of the HKMA's priority supervisory focuses, particularly in light of the anticipated normalisation of interest rates in the US and the potential subsequent reversal of fund flows that could have an impact on AIs' liquidity positions. Throughout 2015, the HKMA continued to implement the enhanced Stable Funding Requirement for AIs to maintain sufficient stable funds to support their lending business. Since the implementation of the Basel III Liquidity Coverage Ratio (LCR) from 1 January 2015, the HKMA has been monitoring the level and trend of LCRs of category 1 institutions, which generally maintained LCRs close to or over 100%, well above the statutory minimum of 60% for 2015 under the phase-in arrangement.

Separately, the HKMA conducted thematic on-site examinations on selected AIs' control framework for managing the risks associated with the anticipated interest rate normalisation. Amid the market volatility, the HKMA also paid close attention to abrupt market changes and their impact on the banking sector as well as individual AIs, and undertook appropriate follow-up action.

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 and adverse economic conditions, and to encourage them to develop plans to address potential problems in times of stress. A number of improvements were introduced during the year to collect more granular information to gain a greater insight into the risk dynamics of selected areas. The HKMA analysed the results submitted by the participating AIs and discussed with them how their stress-testing processes could be further improved.

Credit risk management and asset quality

Credit growth and asset quality

The strong credit growth trend observed in previous years has subsided since the second half of 2015. For the year as a whole, the banking sector's total lending increased by 3.5%, compared with 12.7% in 2014 (Table 2). As customer deposits grew faster than bank lending, the overall loan-to-deposit ratio decreased to 70.1% at the end of 2015 from 72.2% a year ago.

Table 2 Growth in loans and advances

% change	2015	2014
Total loans and advances	**3.5**	12.7
Of which:		
– for use in Hong Kong	**6.3**	13.5
– trade finance	**-16.3**	-1.4
– for use outside Hong Kong	**2.8**	15.1

While credit growth moderated, the asset quality of the banking sector deteriorated slightly in 2015, with the classified loan ratio of retail banks standing at 0.70% at the end of the year, compared with 0.52% a year ago[2], but still well below the long run average of 2.4% since 2000.

Because of these developments, the HKMA enhanced its supervisory effort to ensure the adequacy and effectiveness of AIs' credit risk management systems. The focus of examinations and thematic reviews conducted during the year included the identification and management of problem credit, collateral and guarantee management, and loan underwriting practices. Where weaknesses were identified, the HKMA required the AIs to take appropriate remedial action within a reasonable time. Where more significant issues were identified, the AIs were required to commission an independent party to conduct an in-depth review and adopt appropriate measures to rectify weaknesses as soon as practicable. The HKMA also issued a practice note on credit risk management for loans to the corporate sector to promote prudent underwriting standards and risk management practices.

Property mortgage lending

The HKMA remained vigilant over the property mortgage business of AIs. In February, we introduced the seventh round of countercyclical measures to further strengthen AIs' risk management. This round included lowering the maximum loan-to-value (LTV) ratio for self-use residential properties with a value below HK$7 million to 60%, and tightening the maximum debt-servicing ratio (DSR) for second self-use residential properties from 50% to 40%. In addition, AIs using the IRB approach to manage credit risk are required to extend the risk-weight floor of 15% to all residential mortgage loans (RML) (instead of only those newly granted) by June 2016.

In March, the HKMA issued further guidance that AIs should reduce the applicable DSR cap by five percentage points if the total amount of financing obtained by a borrower, through a combination of mortgage loan and any co-financing or mortgage insurance scheme, exceeded the normal permissible LTV cap by 20 percentage points or above. To uphold the effectiveness of the countercyclical measures, the HKMA required AIs to cease to provide credit to finance companies which offer property mortgage loans that did not comply with the HKMA's prudential requirements.

The seven rounds of countercyclical measures introduced since 2009 have made AIs more resilient to potential credit losses in a property down cycle. The average LTV ratio for newly granted RMLs dropped to 50% in December 2015 from 64% in September 2009 when the first round of countercyclical measures was introduced. The average DSR for new RMLs also dropped to 34% in December 2015 from 41% in August 2010 when the DSR cap was first tightened. The HKMA will continue to closely monitor the property market.

Mainland-related business

The banking sector's Mainland-related lending registered a modest increase amid the Mainland's moderating economic growth. In 2015, the banking sector's total Mainland-related lending increased by 3.2% after a 23.1% rise in 2014, to HK$3,326 billion at the end of the year (Table 3). This included HK$536 billion of loans booked with the Mainland subsidiaries of Hong Kong-based banks.

Table 3 Mainland-related lending

HK$ billion	**2015**	2014
Total Mainland-related lending	**3,326**	3,224
Of which:		
– Mainland-related lending excluding trade finance	**3,050**	2,868
– trade finance	**276**	356

[2] As the lending portfolios of locally incorporated AIs' major overseas subsidiaries have become more material, the coverage of the classified loan ratio is expanded to include these entities. Excluding these entities, the classified loan ratio of retail banks would have stood at 0.63% at the end of 2015, compared with 0.46% a year ago.

The asset quality of Mainland-related lending deteriorated slightly in 2015. With this development and the growing importance of such lending to the local banking sector, the HKMA continued to apply substantial supervisory effort to such exposures during the year. To strengthen supervisory surveillance, the HKMA enhanced the existing surveys to collect more granular data from AIs active in Mainland-related lending for in-depth analysis. In addition, more risk-focused off-site reviews and on-site examinations were conducted, including those of Mainland subsidiaries of locally incorporated banks, to ensure that prudent credit risk management practices were being adopted by the AIs.

Prevention of money laundering and terrorist financing

Given Hong Kong's important role as a regional and global payments hub, the HKMA targeted its specialist supervisory work on AIs' transaction monitoring and screening systems, and sanctions-related controls in 2015. The HKMA also strengthened its capacity to identify significant and emerging risks, conduct thematic work and issue guidance to address some of those risks, such as money laundering controls over tax evasion, for which a guidance paper was issued in March. The programme of risk-based on-site examinations to assess AIs' AML/CFT systems continued, with 21 on-site examinations and 22 desk-based reviews conducted in 2015.

As the risk-based approach is a prerequisite for effective AML/CFT systems in AIs, the HKMA continued to place a strong emphasis on their ability to understand and assess their money laundering and terrorist financing (ML/TF) risks, and provided feedback and other commonly found deficiencies in the annual AML seminar held in November.

The HKMA worked with international and domestic partners to conduct Hong Kong's first jurisdiction-wide ML/TF risk assessment. The assessment, which addresses risks in the banking sector, is expected to be published in 2016.

Risk governance

The HKMA adopts a holistic approach to the supervision of AIs' risk governance and integrates observations about risk culture into its day-to-day supervisory work. During the year, the HKMA held meetings with the boards of directors and, in some cases, arranged separate sessions with the independent non-executive directors (INEDs) of local retail banks to exchange views on risk issues and supervisory matters. The HKMA conducted interviews with the chief risk officers of local retail banks to gain a better understanding of the importance and independence of the risk management function as well as the banks' progress in implementing their risk appetite frameworks. The HKMA also initiated a review of banks' risk management and approval processes for new or expanded products or services.

Talent development

In 2015, the HKMA provided further guidance to the Private Wealth Management Association (PWMA) in implementing the Enhanced Competency Framework for private wealth management practitioners (PWM ECF), which was launched in June 2014. The HKMA encouraged private banks to adopt the PWM ECF benchmark and conducted surveys to monitor the progress of their implementation. According to the survey results, as at end of June 2015, private banks projected that about 90% of a total of some 3,000 relevant private banking practitioners would meet the PWM ECF benchmark by the end of 2016, and virtually all would achieve it by the end of 2017. In addition, some 1,300 relevant practitioners, who have met the PWM ECF benchmark and accumulated sufficient relevant work experience, were granted the professional designation of "Certified Private Wealth Professional" by the PWMA as of December 2015.

Following the successful launch of the PWM ECF, the HKMA worked with the banking industry and the Hong Kong Institute of Bankers (HKIB) to develop an enhanced competency framework for AML/CFT to expand the pool of talent in this area and enhance the professional competence of existing practitioners. In December, the HKMA issued for industry consultation its proposals, and expects to launch the framework by the end of 2016.

Co-operation with overseas supervisors

The HKMA participated in college-of-supervisors meetings organised by the home supervisors of 14 banking groups with significant operations in Hong Kong. Issues of common interest were discussed, including key areas of supervisory focus, financial performance, operations, cyber security, corporate governance, compliance 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 Belgium, Canada, the European Union, Germany, Indonesia, Japan, the Mainland, Malaysia, Macau, the Philippines, Saudi Arabia, 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 attended the crisis management groups (CMGs) of 11 banking groups organised by the relevant home authorities to discuss resolution strategies, oversee production of the recovery and resolution plans and assess the resolvability of each banking group in accordance with the principles established by the Financial Stability Board (FSB). The HKMA also participated in relevant international working groups focused on the development of resolution policy and measures to make resolution operationally feasible.

As an FSB member, the HKMA contributed its views on proposals for the loss-absorbing capacity of global systemically important banks (G-SIBs), cross-border effectiveness of resolution actions, funding for firms in resolution, and operational continuity. 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. The HKMA also organised jointly with the China Banking Regulatory Commission, the HKIB and the China Banking Association a two-day high level seminar for AIs' INEDs.

International co-operation

The HKMA takes part in a range of international and regional forums for banking supervisors. It is currently a member of the Basel Committee on Banking Supervision (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 (PDG), the Supervision and Implementation Group (SIG) and the AML/CFT Expert Group. The HKMA is a member of a number of sub-groups under (i) the PDG, including: the Working Group on Capital, the Trading Book Group, the Working Group on Liquidity, the Working Group on Disclosure, the Large Exposures Group, the Task Force on Standardised Approaches, the Task Force on Interest Rate Risk in the Banking Book and the Task Force on the Scope of Regulatory Consolidation; and (ii) the SIG, including: the Working Group on SIB Supervision, the Working Group on Supervisory Colleges, the SIG Trading Book Group, the SIG Banking Book Group, the Task Force on Impact and Accountability and the Stress Testing Network. In addition, the HKMA participates in the Joint Working Group on Margining Requirements formed by the Basel Committee and the International Organization of Securities Commissions (IOSCO).

The HKMA is a member of the FSB Plenary Meeting, FSB Standing Committee on Assessment of Vulnerabilities and FSB Standing Committee on Supervisory and Regulatory Co-operation. It also participates in a number of FSB working groups including the Resolution Steering Group, the Cross-Border Crisis Management Working Group, the OTC Derivatives Working 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), the South East Asia, New Zealand and Australia Forum of Banking Supervisors and the South-East Asian Central Banks group. 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 conducted surveys and engaged in discussions regarding the implementation of Basel III liquidity standards in the EMEAP jurisdictions.

Implementation of Basel standards in Hong Kong

Capital standards

In January, the HKMA announced a jurisdictional Countercyclical Capital Buffer (CCyB) for Hong Kong at a rate of 0.625% (reflecting the Basel III phase-in provisions), effective 1 January 2016. On 14 January 2016, the HKMA increased the CCyB rate for Hong Kong to 1.25% with effect from 1 January 2017. This decision followed the Basel III phase-in level. Further, in line with the Basel Committee's *Framework for dealing with domestic systemically important banks* (D-SIBs), the HKMA designated five AIs as D-SIBs in March and on 31 December announced the updated list of D-SIBs for 2016, together with their corresponding higher loss absorbency capital requirements to take effect from 1 January 2017.

The Banking (Capital) (Amendment) Rules 2015 addressed some technical differences between the texts of the Banking (Capital) Rules (BCR) and the Basel capital standards which were identified in the Basel Committee's "Assessment of Basel III risk-based capital regulations — Hong Kong SAR" published in March 2015 under its Regulatory Consistency Assessment Programme. Other findings in the report (which concluded that Hong Kong's regulatory capital regime was overall compliant with the Basel framework) will be dealt with in due course when those parts of the Basel capital standards, which are currently being revised by the Basel Committee, are eventually adopted in Hong Kong.

Three sets of standards released by the Basel Committee in 2013 and 2014 are scheduled to be implemented in 2017: *Capital requirements for banks' equity investments in funds* (December 2013); *The standardised approach for measuring counterparty credit risk exposures* (revised in April 2014); and *Capital requirements for bank exposures to central counterparties* (April 2014). The HKMA intends to implement these standards with effect from 1 January 2017, and began consulting the banking industry associations on its proposed approach in November 2015.

Disclosure standards

The Banking (Disclosure) (Amendment) Rules 2014 amended the Banking (Disclosure) Rules (BDR) with effect from 31 March 2015 to introduce new disclosure requirements for AIs in relation to their capital buffers, LCR and leverage ratio in line with Basel III.

In December, the HKMA issued a consultation document on its proposed approach to implementing the Basel Committee's January 2015 *Revised Pillar 3 disclosure requirements* (2015 Pillar 3 Package). The 2015 Pillar 3 Package is the outcome of the first phase of the Basel Committee's review of its existing Pillar 3 framework, which is designed to strengthen regulatory disclosure, particularly in terms of the relevance and comparability of disclosed information for market participants. To this end, the 2015 Pillar 3 Package features a greater use of standard templates and tables, combined with flexibility for banks to provide commentary to reflect bank specific circumstances and risk profiles. Scheduled to take effect from end-2016, the first phase of the review focuses on the disclosure of information related to banks' risk-weighted assets for Pillar 1 risks. The second phase, which is currently in progress, will consolidate the existing Basel III disclosure requirements and specify the disclosure requirements arising from the policy development work currently being finalised by the Basel Committee. The full review will ultimately consolidate all Basel Committee disclosure requirements into a single coherent package.

Implementation of Basel standards in Hong Kong (continued)

Liquidity standards

The Banking (Liquidity) Rules, which implement the Basel III LCR together with a local Liquidity Maintenance Ratio (LMR), came into operation on 1 January 2015. 12 AIs have been designated by the HKMA as "category 1 institutions" and are subject to the LCR requirements, while the LMR requirements are applicable to all other AIs (category 2 institutions). To complement the implementation of the new liquidity ratios, two sets of liquidity monitoring tools were introduced in accordance with guidance issued by the Basel Committee. The *Return on Intraday Liquidity Position of an Authorized Institution* and the *Return on Liquidity Monitoring Tools* were issued respectively in June 2015 (with reporting starting from the position of October 2015) and in September 2015 (with reporting starting from the position of December 2015).

Supplementary guidance for Basel III implementation

The SPM module "Overview of capital adequacy regime for locally incorporated authorized institutions" was updated to reflect the current regulatory capital framework in Hong Kong under Basel III and gazetted in February 2015. The SPM module "Systemically Important Banks", which set out the HKMA's methodology for identifying AIs in Hong Kong to be designated as D-SIBs and G-SIBs, was also gazetted in February 2015.

Two new SPM modules on the operation of the countercyclical capital buffer were issued during the year: "Countercyclical Capital Buffer (CCyB) — Approach to its Implementation" (January 2015) and "Countercyclical Capital Buffer (CCyB) — Geographic Allocation of Private Sector Credit Exposures" (September 2015).

In August, the HKMA issued a revised SPM module "Guideline on the Application of the Banking (Disclosure) Rules" to align with amendments made to the BDR from 2013 for the purposes of implementing the Basel III standards. The revisions also reflected recent changes in prudential reporting requirements relating to AIs' Mainland activities and international claims.

Basel Committee's Regulatory Consistency Assessment Programme

The Basel Committee's Regulatory Consistency Assessment Programme (RCAP) compares each of its member jurisdictions' capital and liquidity requirements against the minimum standards set out in the Basel II, Basel 2.5 and Basel III frameworks. By promoting full, timely and consistent implementation of the Basel standards, the RCAP is intended to strengthen the international banking system, improve market confidence in regulatory ratios and ensure a level playing field.

Having undergone its own RCAP assessment in 2014, the HKMA participated in the RCAP assessments of three other jurisdictions during the year. As the leader of an international team, the HKMA completed an RCAP assessment of India (covering both capital and liquidity standards). The report was published by the Basel Committee in June 2015. The HKMA also joined technical experts from other countries to undertake an RCAP assessment of Russia, and participated in another review team for evaluating the assessment report on the relevant regulations in South Africa.

Improving Supervisory Policy Framework

Credit risk transfer

In November, the HKMA consulted the banking industry associations on a draft module for the SPM on "Credit Risk Transfer Activities" (CRT activities). The module is intended to reflect recent developments in risk management practices for CRT activities and replace the existing SPM module "Credit Derivatives" and Guideline No. 4.6 "Supervisory treatment on asset securitisation and mortgage backed securities".

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

In December 2015, the HKMA released a consultation document and a draft SPM module outlining its proposed approach to implementing global margining and risk mitigation standards for AIs involved in non-centrally cleared OTC derivatives transactions. These standards, developed jointly by the Basel Committee and IOSCO, are designed to reduce counterparty credit risk and limit contagion by ensuring that collateral is available to offset losses caused by the default of a derivatives counterparty; to promote legal certainty over the terms of derivatives contracts; and to facilitate timely resolution of disputes. It is anticipated that the new module will take effect from 1 September 2016, in line with the Basel Committee-IOSCO phase-in schedule.

Exposure limits

Following the release of the Basel Committee's "*Supervisory framework for measuring and controlling large exposures*" in April 2014, the HKMA has initiated a comprehensive review of the current regulatory framework on exposure limits for AIs in Hong Kong. In this review, we are considering approaches for both implementing the Basel Committee's new large exposures framework locally and updating other current regulations on exposure limits which are not directly related to that framework.

The Basel large exposures framework consists of a comprehensive Pillar 1 minimum standard for internationally active banks, which is designed as a simple backstop to complement the risk-based capital standard. Aggregate exposures to single or linked counterparties will, for the most part, be limited to 25% of a bank's Tier 1 capital limit. A stricter 15% limit will apply to exposures between G-SIBs.

In the light of AIs' increasing derivatives activity, the HKMA revised the *Return of Large Exposures* in June 2015 to gather more relevant data for the supervisory monitoring of exposures arising from OTC derivatives transactions and credit derivatives contracts.

Exposures to connected parties

Following industry consultation, an updated SPM module "Exposures to Connected Parties" was gazetted in November 2015. The revisions were primarily designed to address two recommendations from the International Monetary Fund (IMF) following its assessment of Hong Kong's compliance with the Basel Committee's *Core Principles for Effective Banking Supervision* (Basel Core Principles) in 2014 under its Financial Sector Assessment Program. Specifically, for the purpose of an AI's internal risk management, the definition of connected parties in the module has been aligned with that under "Principle 20: Transactions with related parties" of the Basel Core Principles. In addition, any write-off of exposures to connected parties exceeding a specified amount, or otherwise posing special risks to the AI, is required to be approved by the AI's Board (or its Credit Committee or other relevant Board Committee).

Accounting standards

Following release of IFRS 9 *Financial Instruments* by the International Accounting Standards Board (IASB) in July 2014, various initiatives have been undertaken by standard-setting bodies to promote robust and consistent application of IFRS 9 or of the expected credit loss accounting framework of the US Financial Accounting Standards Board (FASB) across jurisdictions. These include a specific Transition Resource Group established by the IASB to act as a discussion forum to provide support for stakeholders on implementation issues pertaining to IFRS 9, and the issuance by the Basel Committee of new supervisory guidance on accounting for expected credit losses. The FSB has also called on the International Auditing and Assurance Standards Board to develop audit guidance to support implementation of the new impairment requirements. Domestically, the HKMA continued discussions with bank auditors on AIs' preparation for the implementation of IFRS 9.

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 international and domestic developments in relation to new or revised accounting, auditing and financial reporting standards and their implications for banks, as well as major international and domestic banking regulatory developments.

Recovery and resolution

The HKMA, together with the FSTB, the Securities and Futures Commission (SFC) and the Insurance Authority, continued to take forward proposals for the implementation in Hong Kong of an effective cross-sector resolution regime for financial institutions. The regime is designed to meet the *Key Attributes of Effective Resolution Regimes for Financial Institutions* (Key Attributes) prescribed by the FSB, and to enhance the resilience of the local financial system against the risks that could be posed to financial stability and public funds in the unlikely event that a financial institution with potential systemic impact were to fail.

All FSB member jurisdictions are expected to adopt the standards set by the Key Attributes. A self-assessment carried out by the authorities in Hong Kong (and subsequently confirmed by the FSB and the IMF) established that while a relatively well-developed statutory and regulatory framework is already in place to deal with distressed financial institutions, some significant gaps still exist when compared to the full range of powers now deemed necessary for an effective resolution regime in the Key Attributes. Therefore, legislative reform is required to achieve compliance locally with the Key Attributes.

Significant progress was made on the necessary reforms during 2015. Following the first public consultation in 2014, a second was launched in January and the consultation response to both was issued in October. Throughout the process, a majority of stakeholders indicated broad support for the reforms' objective and provided constructive comments to support the effective development of the regime. A major milestone was reached in December with the introduction of the Financial Institutions (Resolution) Bill (FIRB) into the Legislative Council, following its publication in the Government Gazette in November.

In parallel with the development of these legislative reforms, the HKMA has continued with its implementation of "recovery planning" requirements for AIs, which were first introduced in June 2014. To date, 19 AIs have submitted recovery plans to the HKMA.

Bank consumer protection

Code of Banking Practice

Following a comprehensive review of the Code in 2014 by the Code of Banking Practice Committee, on which the HKMA is represented, the revised Code became effective on 6 February 2015 to offer better protection to consumers of bank services. AIs are expected to take steps to comply with the revised provisions as quickly as possible and achieve full compliance within six months. A further six-month grace period was allowed for compliance with the revised provisions where system changes are required. The HKMA conducted a progress survey in Q4 to monitor AIs' implementation of the revised Code and will continue to monitor their compliance as part of its supervision of AIs.

Treat Customers Fairly Charter

In line with the spirit of promoting a customer-centric culture and fostering financial inclusion under the Treat Customers Fairly Charter, the banking industry is responding positively to the HKMA's call for the provision of adequate basic banking services to the public. A number of banks took the lead in leveraging advancements in technology to introduce mobile branch and video teller machines to enhance access to basic banking services.

Chief Executive of the HKMA, Mr Norman Chan, speaks at the launch ceremony of a mobile branch.

To facilitate opening of bank accounts by the general public, including the ethnic minorities, the HKMA arranged a sharing session in April for ethnic minority organisations and representatives of the banking industry to share perspectives and exchange views in order to improve communication among different stakeholders. Since then, the industry has enhanced the accessibility of basic information about account opening procedures and improved staff training to ensure better customer communication and cultural sensitivities. In June, the HKMA issued further guidance to retail banks in relation to the provision of banking services and support for fund raising activities of non-government organisations.

The HKMA conducted a thematic examination and ongoing monitoring of AIs' implementation of the Treat Customers Fairly principles and related policies and controls in relation to the provision of basic banking services.

Various policies and measures were also introduced to help further protect the interests of bank consumers. In the light of a surge in the number of bogus phone calls purportedly from banks, the HKMA issued in July a circular to require all retail banks to publicise "fraud alerts" on their websites and other channels to draw customers' attention to suspicious calls. In August, another circular was issued requiring all AIs to cease the use of intermediaries for sourcing customers for retail non-collateralised financial products or services. The public was made aware that calls from intermediaries for these referrals would then be potentially fraudulent. The HKMA also required all retail banks to provide customer hotlines to facilitate the public in verifying the identity of callers, and jointly organised with the industry the "Beware of Fraudulent Calls, Verify the Caller's Identity" publicity campaign to raise awareness of phone scams and remind the public to be vigilant about safeguarding their personal data.

Deputy Chief Executive of the HKMA, Mr Arthur Yuen, and representatives of the HKAB and 21 retail banks at the launch ceremony of the "Beware of Fraudulent Calls, Verify the Caller's Identity" publicity campaign.

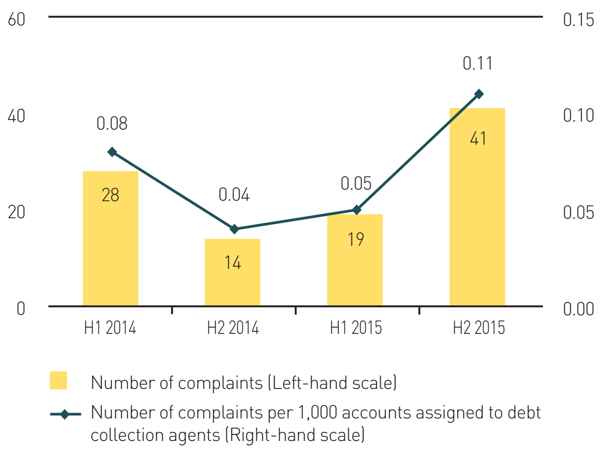
Credit data sharing

At the end of 2015, 114 AIs and subsidiaries of AIs were sharing commercial credit data through the Commercial Credit Reference Agency. The scheme contains the credit data of more than 122,900 business enterprises, about 16% of which were sole proprietorships and partnerships.

Customer complaints relating to debt collection agents employed by AIs

The number of complaints received by AIs about their debt collection agents increased to 60 from 42 in 2014 (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's Consumer Education Programme aims to educate the public to be smart and responsible in the use of banking services. One of the initiatives in 2015 was the introduction in December of a new TV drama series entitled "All about Banking", jointly developed with Radio Television Hong Kong (RTHK). The eight-episode five-minute drama series, broadcast on TV, the RTHK's website, YouTube Channel Page and the "RTHK Screen" smartphone application, covered smart tips on a range of banking services. To stimulate public interest in the series, various publicity channels were used including print, the internet, mobile and out-of-home media. A promotion game was also run jointly with a free Chinese daily newspaper.

One episode in the "All about Banking" series reminds consumers to check on fees when using credit cards overseas.

In the light of a surge in bogus phone calls purportedly from banks since July, the HKMA collaborated with the Hong Kong Association of Banks in producing a TV and a radio Announcement in the Public Interest (API) to remind the public that banks no longer accepted intermediary referrals for personal loans or credit card applications. The API alerted the public not to divulge their personal data without first verifying the callers' identity through their respective bank hotlines. The announcement was broadcast through the electronic media, and augmented with telecasts on public transport, popular anchor sites and smartphone applications, the HKMA website and the HKMA Smart Tips Channel on YouTube. There were other promotions in the print and out-of-home media.

A new API raises public awareness about bogus phone calls purportedly from banks.

Thematic campaigns were conducted on responsible credit card spending, smart tips on personal loans, and the importance of verifying the authorization status of a financial institution before placing a deposit. In addition to the publication of feature articles, a lively comic strip was also used to educate the public.

A novel way to alert the public on banking issues.

To sustain the HKMA's educational efforts, light-hearted audio clips were broadcast during the year promoting smart tips on different topics. And, the screening of four short video clips on minimum payment of credit cards and self-banking services was extended to TV, cinemas, extra public transport, smartphone applications and the internet, in addition to the HKMA's website, Information Centre, Coin Carts and YouTube Channel Page.

A cross-media campaign sustains promotion of the video series.

On youth programmes, the HKMA co-organised the "Hong Kong Liberal Studies Financial Literacy Championship" with various stakeholders to promote financial literacy among senior secondary school students. Winners of this online quiz learnt more about the HKMA's work through a visit to the Information Centre and a "Meet the HKMA Chief Executive" session. An educational kit containing the material from the online quiz was sent to all secondary schools for use in post-examination activities. Talks for senior secondary school and university students advocating responsible spending continued during the year.

Three winning students chat on stage with the Chief Executive of the HKMA, Mr Norman Chan.

The HKMA continued to support the Investor Education Centre in promoting financial literacy in Hong Kong, collaborating in the publication of a joint article on renminbi structured deposits in *Choice Magazine*, and providing advice on educational materials on various themes, as well as acting as a supporting organisation in the launch of the "Hong Kong Strategy for Financial Literacy".

Deposit protection

The Deposit Protection Scheme (DPS) continued to provide protection to deposits up to HK$500,000 per depositor per bank. Public consultation on proposals to enhance the Scheme by achieving faster payouts, mainly through the adoption of a gross payout approach, was completed. The responses received indicated broad support for the proposals in view of the benefits of prompt payouts to depositors and reinforcing the effectiveness of the DPS as part of Hong Kong's financial safety net. Taking into account the comments from the consultation process, legislative amendments to implement the new measures were introduced into the Legislative Council in November 2015. The amendments will take immediate effect upon passage by the Legislative Council. They will enable, in the event of a bank failure, deposit compensation payments to be made to depositors in seven days under most circumstances.

A new programme for monitoring the compliance of DPS member banks (Scheme members) with the enhanced information requirements became fully effective in 2015 to ensure they are ready at all times to provide deposit records within the specified timeframe. The first annual self-certification of compliance submitted by Scheme members indicated satisfactory compliance. A payout rehearsal also verified the operational effectiveness of payout preparation by the Hong Kong Deposit Protection Board after receiving an early notification of a potential payout from the HKMA.

The annual self-assessments completed by Scheme members and on-site examinations conducted by the HKMA continued to be an effective mechanism for monitoring compliance of Scheme members with the requirements in relation to representations about DPS protection. The compliance level was generally satisfactory.

Multi-media publicity campaigns and community education programmes were launched during the year which helped maintain a high public awareness of the DPS. In addition, to capture the attention of a growing digital-savvy market, an inaugural effort was made to employ social media to introduce the DPS to a wider audience, particularly the younger generation.

Licensing and Director Empowerment Programme

At the end of 2015, Hong Kong had 157 licensed banks, 24 restricted licence banks, 18 deposit-taking companies and 15 approved money brokers. During the year, the HKMA granted one banking licence to a local subsidiary of a foreign bank, two restricted banking licences (one to a locally incorporated company and one to a local subsidiary of a foreign banking group), and upgraded a local deposit-taking company subsidiary of a foreign bank to a restricted licence bank. Three licensed banks and five deposit-taking companies (one of which was upgraded to a restricted licence bank) revoked their authorization during the year.

The HKMA continued to work with the HKIB to support the skills and knowledge development of directors of locally incorporated AIs. In 2015, the HKIB organised four seminars for directors and senior executives of banks on topical issues to keep them up to date with developments in the industry and regulatory requirements. The topics included Basel III, Mainland-related business, risk culture and the proposed resolution regime. To further enhance the director development programme, the HKMA collaborated with the HKIB in conducting a survey on the training and development needs of directors, which also incorporated the areas in which they were interested. The survey results will be followed up by the HKMA and the HKIB.

INEDs play an important role in ensuring appropriate risk governance in the conduct of AIs' business. In this context, the HKMA continued to arrange informal experience-sharing sessions to support recently-appointed INEDs in managing ongoing challenges facing them and the banking industry generally.

To help improve the competitiveness of the local banking sector in attracting suitably qualified and experienced people as INEDs and to facilitate them to play their roles, the HKMA commissioned a small study group of experts on corporate governance to make recommendations on how best Hong Kong could equip and empower the INEDs to promote the culture and further development of good governance in locally incorporated AIs. The banking industry and other relevant stakeholders will be consulted on the recommendations.

Enforcement

Banking complaints

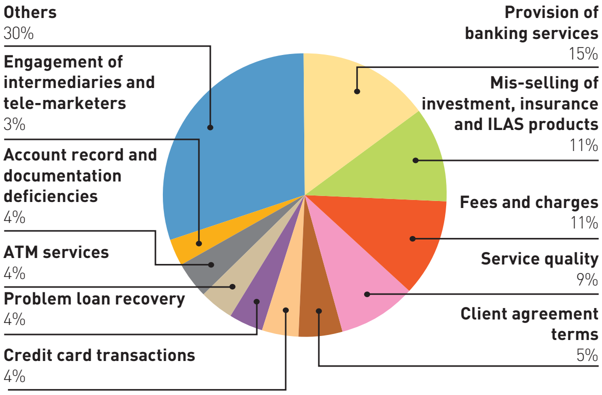
The HKMA received 1,608 complaints against AIs and members of their staff, a 30% increase over a year earlier, and completed the handling of 1,469 cases in 2015. At the end of the year, the total number of outstanding cases was 539 (Table 4).

Table 4 Banking complaints received by the HKMA

	2015			2014
	Conduct-related issues	General banking services	Total	Total
In progress on 1 January	160	240	**400**	500
Received during the year	252	1,356	**1,608**	1,234
Completed during the year	(194)	(1,275)	**(1,469)**	(1,334)
In progress on 31 December	218	321	**539**	400

Complaints relating to the provision of banking services continued to rank highest in 2015, increasing by 35% to 237. The increase was mainly due to complaints about the termination of banking relationships by AIs following the completion of customer due diligence processes resulting in AIs ceasing to provide banking services. The overall number of complaints related to the mis-selling of investment, insurance and investment-linked assurance scheme (ILAS) products increased by 1% to 174. But, following the depreciation of the renminbi, there was a notable increase in complaints relating to the mis-selling of foreign exchange accumulators linked to the renminbi from corporate customers by 314% to 29. The number of complaints related to client agreement terms increased by 40% to 73 and those involving credit card transactions increased by 31% to 72. Complaints concerning ATM services rose by 37% to 70, and those related to problem loan recovery also surged by 32% to 70. Other major types of complaints included those related to account record and documentation deficiencies, up 90% to 57, and complaints about AIs' engagement of credit intermediaries and tele-marketers to solicit loan business, up 38% to 55 (Chart 2).

Chart 2 Types of service or product concerned in banking complaints received by the HKMA



New complaint-related materials on the HKMA website

As one of the HKMA's initiatives to promote more transparent and effective communication with the public, a set of frequently asked questions together with a flowchart of the HKMA's complaint handling process, was uploaded to the HKMA website in May to enhance the public understanding of the HKMA's role and procedures in the handling of complaints about banks. In addition, a revised version of the complaint form with refined completion instructions was introduced to make it more user-friendly.

Enforcement action

In July, the HKMA was the first regulatory authority to exercise its disciplinary power under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (AMLO) when it took disciplinary action against the State Bank of India, Hong Kong Branch (SBIHK) for contraventions of four specified provisions under the AMLO relating to customer due diligence, the obligation to continuously monitor business relationships with customers, the obligation to establish and maintain effective procedures for determining whether customers are politically exposed persons and the obligation to establish and maintain effective procedures to ensure compliance with specified provisions concerning customer due diligence and ongoing monitoring. The HKMA reprimanded SBIHK, imposed a pecuniary penalty of HK$7,500,000 and ordered SBIHK to submit the report of an independent external advisor regarding the sufficiency of SBIHK's remedial plan and the effectiveness of its implementation. The disciplinary action served not only as a deterrent to an individual institution, but also to the industry generally and underlined the importance of maintaining effective systems and controls to combat money laundering and terrorist financing.

Also in July, the HKMA suspended the registration of a serving relevant individual (RelI) for 10 weeks under the Banking Ordinance. The suspension followed an investigation which found the RelI guilty of misconduct and not a fit and proper person, in that the RelI had failed to obtain the specific instructions of the client before effecting certain investment transactions and to record the order instructions of the client for those transactions, contrary to regulatory requirements.

Disciplinary sanctions, ranging from suspension to life ban, were imposed during the year by the SFC on two RelIs following referral by the HKMA. The HKMA also issued 31 compliance advice letters to AIs and their staff who were found not to have acted in full compliance with the relevant regulatory requirements, but the cases involved minor lapses that did not warrant disciplinary sanctions.

Complaints Watch

In a continuing initiative to promote proper standards of conduct and prudent business practices among AIs, three issues of *Complaints Watch* were published in 2015, drawing AIs' attention to trends in banking complaints and emerging topical issues. The topics covered in the newsletters included: unauthorised transactions by banks' relationship managers; remittance frauds; disclosure of early repayment terms and related charges for personal loans; the fraudulent use of lost ID cards; the execution of customer due diligence measures; and, the engagement of credit intermediaries in loan solicitation.

Oversight of financial market infrastructures

The HKMA issued a policy statement in 2013 setting out its approach to the oversight of 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. On 13 November 2015, the CSSO was amended and renamed the Payment Systems and Stored Value Facilities Ordinance (PSSVFO). While the major amendments established a regulatory regime for the retail payment systems and the stored value facilities, some of the provisions applicable to the large-value clearing and settlement systems were revised to further enhance the legal framework for overseeing such systems. The purpose of the Ordinance 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/PSSVFO. 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 adopts international standards in 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 the 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 an amended statutory "Guideline on the Oversight Framework for Designated Systems" under the CSSO and a new "Guideline on the Oversight Framework for the Hong Kong Trade Repository". The two Guidelines are being revised to take into account developments, including changes to reflect the amendments arising from the PSSVFO. The revised Guidelines will be issued in early 2016.

Except for the CLS System, the HKMA oversees other FMIs under its purview 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 continued to work with the FMIs under its purview to ensure observance of the PFMI and substantive progress has been made by the FMIs to align with the PFMI requirements. All the FMIs have prepared and published Disclosure Frameworks, which is a key requirement under the PFMI to improve transparency by disclosing system arrangements principle by principle.

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. By the end of 2015, the HKMA had participated in the Level 1 assessment which examined whether a regulatory authority has completed the process of adopting legislation and other policies to enable it to implement the principles and responsibilities for overseeing FMIs, and a combined Level 2 and Level 3 assessment to examine whether a regulatory authority has effectively implemented the responsibilities for overseeing the FMIs. The HKMA obtained the highest ratings in both assessments.

The HKMA is also a member of the Oversight Forum of the global message carrier SWIFT, 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 CLS System continued to meet the safety and efficiency requirements under the CSSO/PSSVFO.

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 the USD CHATS and the Malaysian Ringgit, Indonesian rupiah, and Thai baht RTGS systems. During the year, the HKMA also held bilateral meetings with the National Bank of Belgium (NBB), the Luxembourg Commission de Surveillance du Secteur Financier (CSSF) and the Banque centrale du Luxembourg (BCL) to discuss matters concerning the links between the CMU and the two international central securities depositories, Euroclear (NBB) and Clearstream (CSSF & BCL). The HKMA will continue to work with the relevant authorities to further strengthen co-operative oversight arrangements where appropriate.

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. The tribunal was renamed the Payment Systems and Stored Value Facilities Appeals Tribunal after the PSSVFO came into effect on 13 November 2015. 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/PSSVFO to systems in which the HKMA has a legal or beneficial interest. The terms of reference of the Committee were revised to reflect the amendments made in the PSSVFO. The Committee assesses whether the HKMA has applied the same procedures to all designated systems. The Committee met twice in 2015 and reviewed four regular reports and 22 accompanying oversight activities' management reports. The Committee concluded that it was not aware of any case where the HKMA had not duly followed the internal operational procedures, or where the HKMA had not been procedurally fair in carrying out its oversight activities. Under its terms of reference, the Committee submitted its annual report to the Financial Secretary, which is available on the HKMA website.

PLANS FOR 2016 AND BEYOND

Supervisory focus

Asset quality

Amid uncertain global economic conditions and the normalisation of interest rates in the US, AIs should remain vigilant in managing their credit risk. With heightened concerns about the possible impact on fund outflows and asset price volatility, the HKMA will continue to closely monitor the asset quality of AIs' lending portfolios and promote sound credit risk management by AIs to ensure the resilience of Hong Kong's banking system to the potential downturn in the credit cycle.

Mainland-related business

The HKMA will continue to take a meticulous approach to ensure that AIs are adopting prudent credit underwriting and risk management practices for their Mainland-related business. On-site examinations and off-site reviews of AIs' risk management systems for such business, and detailed analyses of AIs' relevant data, will remain the key supervisory tools. In addition, the HKMA will maintain close dialogue with the industry to further promote sound credit risk management practices in conducting Mainland-related business.

Prevention of money laundering and terrorist financing

The HKMA will continue its programme of risk-based examinations on AIs which may present higher inherent ML/TF risks. Where serious shortcomings in AML/CFT systems and controls are identified, the HKMA will continue to adopt a policy of early intervention by using a full range of supervisory tools and powers provided under the AMLO and the Banking Ordinance.

The HKMA will continue to support AML/CFT policy development, contribute to Hong Kong's first ML/TF risk assessment and review Hong Kong's legal and regulatory regime for AML/CFT purposes to ensure it is fully aligned with the latest international standards and practices. The HKMA will maintain a high level of industry engagement and work closely with industry associations to develop guidance on certain specific areas, such as trade finance.

Risk governance

The HKMA will maintain regular supervisory interaction with the boards of directors and senior management of local retail banks to evaluate governance effectiveness and identify room for improvement.

Supervision of treasury activities and liquidity risk

Additional resources will be allocated to regularly monitor selected AIs' treasury activities and funding conditions to identify potential market and liquidity risks, especially amid the commencement of the normalisation of interest rates in the US and other market dynamics. In particular, the HKMA will continue with the implementation of the Basel III liquidity regime and other supervisory initiatives to reduce the liquidity risk of the banking system. The HKMA will also assess the risk management capability of selected AIs in dealing with contingency liquidity stress scenarios. In addition, the HKMA will continue to conduct on-site examinations and thematic reviews of selected AIs' risk management measures against the risk of adverse market movements.

Supervision of operational and technology risks

To keep pace with the regulatory and industry sound practices, the HKMA will commence the revision of the SPM modules related to business continuity planning and outsourcing. Other policy guidance, including the periodic "*Operational Incidents Watch*", will be issued to further improve operational and technology risk management among AIs.

The HKMA will continue to conduct risk-based on-site examinations and off-site reviews to identify major operational and technology risks and to examine the adequacy of AIs' relevant risk management controls. These will focus on areas including cyber security risk management and the operational resilience of AIs that are more important to the stability and effective functioning of Hong Kong's monetary and banking systems.

There will be further collaboration with the industry and other stakeholders in promoting the security awareness of bank customers when using e-banking services. The HKMA will also work with the industry to improve co-operation and sound practices in AIs' card services and emerging payment products.

Supervision of wealth management and MPF-related businesses

The HKMA will:

- continue to communicate closely with other regulators and the banking industry to provide guidance on the standards the HKMA expects institutions to observe in the sale of investment and insurance products;

- 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 foreign exchange accumulators and NLTI products, as well as AIs' compliance with new regulatory requirements;

- co-operate with the Government and the Insurance Authority on the preparatory work for implementing the new statutory regime for regulating insurance intermediaries; and

- maintain dialogue with, and provide guidance to, the industry to promote a customer-centric culture and good conduct within the banking sector.

Supervisor-driven stress testing programme

The HKMA will further develop and improve the supervisor-driven stress testing programme as one of the tools for supervising AIs' capital management. AIs are expected to further enhance their stress testing capability taking into account such matters as the experience gained in the supervisor-driven stress testing programme, and to better integrate their stress testing into the capital planning processes.

Talent development

The HKMA will continue working with the banking industry and the HKIB on the introduction of the ECF on AML/CFT in 2016. The HKMA will also initiate discussions with the industry and relevant professional bodies on its plan to launch similar competency frameworks for other streams of professional work in the banking sector. These are expected to include risk management, compliance and internal controls, treasury management, credit risk management and retail wealth management.

Co-operation with overseas supervisors

Major priorities will include working with the crisis management groups of internationally active banks on formulating recovery and resolution strategies and plans in accordance with the timetable set by the FSB. The HKMA will seek to ensure the timely sharing of bank-specific information with overseas supervisors on prudential and other matters, including the latest developments on liquidity and solvency positions. With the creation in 2014 of the Single Supervisory Mechanism in Europe, the HKMA is negotiating with the European Central Bank on the establishment of a memorandum of understanding for the exchange of supervisory information and co-operation.

Implementation of Basel standards in Hong Kong

Capital standards

The HKMA will develop a set of Banking (Capital) (Amendment) Rules 2016 (BCAR 2016) to incorporate into the BCR the Basel capital standards on banks' counterparty credit risk (CCR) exposure and equity investments in funds, taking into account comments received from the industry consultation at the end of 2015. Further industry consultation on the text of the amendments is expected to commence in the second quarter of 2016, with the rules being finalised for submission to the Legislative Council later in the year for negative vetting. The intention is for the amendments to become effective on 1 January 2017 in line with the Basel Committee timeline.

The Basel Committee published a set of *Revisions to the securitisation framework* in December 2014, and a consultation document on the *Capital treatment for "simple, transparent and comparable" securitisations* in November 2015. The HKMA intends to incorporate both the revised securitisation framework and the proposed capital treatment for simple, transparent and comparable securitisations into the BCR once finalised. Industry consultation on the policy proposals for local implementation is expected to be conducted in 2016.

The Basel Committee issued in January 2016 its final standards on *Minimum capital requirements for market risk*. This new set of market risk standards completes the Committee's fundamental review of the trading book and addresses shortcomings of the current standards identified in market stress periods of recent years. The HKMA's current intention would be to implement the revised market risk capital framework in accordance with the Basel Committee's timetable (i.e. implementation by national supervisors by 1 January 2019; reporting by banks under new standards from 31 December 2019). The HKMA plans to consult the industry on its implementation proposals for Hong Kong in due course, taking account of the progress of the Committee in finalising related standards that may have an impact on the revised market risk capital framework.

The Basel Committee has been undertaking a review of the current standardised approach for the calculation of capital requirements for credit risk. The review seeks to reduce reliance on external credit ratings, enhance granularity and risk sensitivity, update risk weight calibrations, and increase comparability with the IRB approach for the calculation of capital requirements for credit risk. The Basel Committee issued a second consultation document in December 2015 setting out further proposed revisions, having regard to comments received from a previous consultation on the same subject in December 2014.

Implementation of Basel standards in Hong Kong (continued)

To streamline and enhance the risk-sensitivity of the current framework for calculating operational risk capital requirements, the Basel Committee has developed a new Standardised Measurement Approach to replace the three non-model-based approaches as well as the Advanced Measurement Approach under the current framework. A second consultation document was issued in March 2016 setting out further proposed revisions, having regard to comments received in response to the first consultation launched in October 2014.

The HKMA expects to implement the final standards in accordance with the Basel Committee timetable, and will develop policy proposals for this purpose, in consultation with the industry, once the final standards are issued by the Basel Committee.

Disclosure standards

Implementation of the 2015 Pillar 3 Package (referred to in the box entitled "Implementation of Basel standards in Hong Kong" under "Review of 2015") will require amendment to the BDR and the release of supplementary guidance specifying the relevant standard templates and tables for disclosure. In order to adhere to the Basel Committee's timetable, the HKMA intends to develop the necessary legislative amendments and issue the guidance so that both will be applicable to AIs for their disclosures for the financial year ending on or after 31 December 2016.

As a continuation of its endeavours to update and consolidate regulatory disclosure requirements into a single coherent package, the Basel Committee released a second consultation document in March 2016 setting out proposals to consolidate and update existing disclosure requirements under Basel III, and specifying certain new requirements to enhance the Pillar 3 framework.

Liquidity standards

Following the implementation of the LCR and LMR, the HKMA will make corresponding revisions to the two SPM modules relating to liquidity risk management during 2016. Moreover, under the Basel Committee's timeline, the Net Stable Funding Ratio (NSFR), which is the second of the two liquidity ratios (alongside the LCR) specified in the Basel III standard, is scheduled to be implemented on 1 January 2018. The HKMA has been conducting quantitative impact studies on the NSFR and intends to consult the industry in 2016 on policy proposals for local implementation.

Development of Supervisory Policies

Counterparty credit risk

The HKMA intends to issue a revised SPM module on "Counterparty Credit Risk Management" for industry consultation during 2016. The revisions will bring the module's guidance in line with the latest capital treatment for CCR under the BCR, including the changes to be introduced by the proposed BCAR 2016, and will reflect recent developments in CCR management practices.

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. This was followed in July 2015 with the issuance by the Basel Committee of a final document on *Corporate governance principles for banks*. The HKMA is updating the SPM module "Corporate Governance of Locally Incorporated Authorized Institutions" to reflect the latest international standards and will consult the industry during 2016 on the text of the revised module.

Exposure limits

The HKMA issued a consultation paper on proposed revisions to the exposure limits framework in March 2016 and intends to follow up during the year with a local quantitative impact study to test the impact of the policy proposals. An amendment bill will be required to amend Part XV of the Banking Ordinance and the law drafting process will commence during the year.

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 intends to issue updated supervisory guidance for AIs that will reflect this new international standard.

Updating other supervisory policies and risk management guidelines

In addition to those SPM modules specifically mentioned above, the HKMA also plans to update a selection of other modules to incorporate the latest guidance issued by the Basel Committee and other international standard-setters. These include the SPM modules on: the Pillar 2 supervisory review process; general risk management controls; internal audit and compliance functions; and the validation of risk-rating systems under the IRB approach for credit risk.

Recovery and resolution

The HKMA will work closely with the FSTB, the SFC and the Insurance Authority to secure the passage of the FIRB by the Legislative Council. The FIRB makes provision for the issuance of several sets of subsidiary legislation in the form of rules and regulations on various aspects of the resolution regime as well as for the publication of a code of practice to provide greater detail on how a resolution authority would expect to exercise the powers conferred on it under the FIRB. The HKMA will participate in the development of such rules, regulations and code.

In parallel with the legislative process, the HKMA will also be working to develop the necessary methodologies, processes and procedures to make the proposed new resolution regime operational.

In this regard, the HKMA will continue with the implementation of "recovery planning" for AIs and will complement this with the development of frameworks for the conduct of resolution planning and the assessment of AIs' resolvability. For this purpose, an SPM module "Resolution Planning" will be issued for industry consultation in spring 2016.

In relation to resolution planning at the international level, the HKMA will continue its participation in the various CMGs of which it is a member. Also at the international level, the HKMA will continue to contribute to FSB and other working groups focused on the development of resolution policy and the means by which resolution can be made operationally feasible and credible.

Accounting standards

With the impending application of IFRS 9 to banks, the HKMA will update its prudential framework for AIs as appropriate, taking into account the new supervisory guidance on accounting for expected credit losses issued by the Basel Committee. Part of this work will include considering the need to make amendments to banking returns, loan classifications and inputs into the regulatory capital calculation. The HKMA will maintain close contact with the HKICPA and the banking industry as it prepares for the implementation of IFRS 9.

Bank consumer protection

The HKMA will continue to promote good banking practices through participation in and providing advice to the Code of Banking Practice Committee. It will monitor AIs' implementation of the revised Code and will review AIs' compliance with the Code through on-site examinations and handling relevant complaints on AIs.

The HKMA will continue its effort in developing a customer-centric culture among AIs and fostering financial inclusion by retail banks under the Treat Customers Fairly Charter, especially securing reasonable access to basic banking services by members of the public. The HKMA will also continue to participate in international efforts to drive better protection for financial consumers through participation in the Organisation for Economic Co-operation and Development (OECD) Task Force on Financial Consumer Protection.

Bank consumer education

Further initiatives will be launched under the HKMA's Consumer Education Programme, including the production of new video and audio clips, to encourage the public to be smart and responsible in the use of banking services. New activities will be introduced to promote financial literacy and responsible spending to the youth generation. In addition, the HKMA will continue to collaborate with other stakeholders to maximise the impact 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.

Deposit protection

The Deposit Protection Scheme (Amendment) Bill 2015 was introduced into the Legislative Council on 25 November 2015. Various operational functions of the DPS are being reviewed to identify areas where adjustments are necessary to ensure a smooth transition to the gross payout approach upon passage of the Bill. The relevant preparations include revising the contribution assessment and reporting requirements of Scheme members, as well as updating the payout system and procedures. There will also be co-ordination with the banking industry for any system changes required for Scheme members to submit deposit records for determining deposit compensation payment on a gross basis.

The compliance programme for monitoring Scheme members' readiness to submit data in accordance with the information system requirements will continue. Six compliance reviews and simulation tests will be conducted in 2016. Self-assessments and on-site examinations will continue to be employed to monitor the compliance of Scheme members with the representation requirements on DPS membership and protection status of financial products. Taking the opportunity of the 10th anniversary of the DPS in 2016, publicity strategies will be devised to further boost public awareness and understanding of the DPS.

Enforcement

In addition to deploying resources to handle any mis-selling cases, the HKMA will deploy additional resources to handle enforcement functions under the AMLO and other Ordinances.

The HKMA will continue to closely monitor potentially systemic conduct-related issues of AIs through the complaints received and, where appropriate, take prompt action to contain or mitigate any adverse consequences; and to alert the industry and share information with the public to enhance awareness.

Director empowerment programme

After the forthcoming consultations with the industry on the study group's recommendations on how INEDs can be properly equipped and empowered to discharge their duties, the HKMA expects to issue relevant guidance. The HKMA will also continue to work closely with the industry to further enhance the director empowerment programme and launch further initiatives, where appropriate, to help facilitate the performance of the role of INEDs.

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 PSSVFO and the relevant international requirements.

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