Banking Stability

The banking sector in Hong Kong remained sound and stable in 2020, notwithstanding the outbreak of COVID-19 pandemic causing significant headwinds to the economy. During the year, the HKMA monitored closely and responded in an agile manner to the impact of the pandemic on banking operations and supervisory activities, while maintaining its focus on the supervision of the credit and liquidity risk management of authorized institutions. In view of escalating cyber threats and the industry's growing adoption of technology, the HKMA stepped up the supervision of authorized institutions' technology risk management and operational resilience. The HKMA also worked closely with banks and international bodies to facilitate the transition to alternative reference rates.

On conduct supervision, the HKMA provided regulatory flexibilities and guidance to facilitate banks' operations and continued services to customers, while safeguarding protection to investors and consumers amid the pandemic. Together with relevant authorities, the HKMA developed and consulted the industry on the proposed implementation details for the cross-boundary wealth management connect pilot scheme. Working with the Securities and Futures Commission, guidance was provided on streamlining the selling processes for family offices and high net worth investors with financial sophistication. In addition, the HKMA enhanced consumer protection in digital financial services and continued to promote a customer-centric corporate culture.

On anti-money laundering and counter-financing of terrorism (AML/CFT), the HKMA has acted swiftly to clarify how the risk-based approach and technology could help authorized institutions better respond to the COVID-19 situation, while also carefully managing the impact of rising geopolitical tensions on the banking sector. The HKMA continued to champion initiatives to enhance the effectiveness and efficiency of AML/CFT work, including expanding the number of authorized institutions involved in information sharing in the public-private partnership, as well as supporting Regtech adoption in the banking industry. The HKMA has also embarked on a programme to further enhance AML/CFT surveillance capability to respond to the international trend of leveraging technology and data.

Meanwhile, the HKMA has worked closely with the banking industry in optimising supervisory policies and processes and in carrying out capacity-building initiatives to facilitate talent development. Good progress was made on the local implementation of international supervisory standards, including capital adequacy standards and disclosure standards. On promoting green and sustainable banking, the HKMA has moved forward with phase two of the three-phased approach in formulating relevant supervisory requirements. The HKMA also continued to advance its work to ensure a credible resolution regime for authorized institutions, including developing new resolution standards and implementing rules on loss-absorbing capacity requirements to enhance authorized institutions' resolvability.

Banking Stability

OBJECTIVES

The HKMA has a general objective to promote the safety and stability of the banking system. Achieving this objective is contingent upon the financial system being highly resilient and capable of providing the critical financial services the Hong Kong economy needs.

Banks can affect the stability of the system through the way they carry out their businesses and, in extremis, by failing in a disorderly manner. The Monetary Authority, as a supervisory authority, plays a key role in safeguarding financial stability by ensuring banks are resilient to shocks and able to recover their positions in response to crises, ultimately helping to prevent failures. The Monetary Authority is responsible for the prudential supervision of banks in Hong Kong. It is tasked with the authorization of licensed banks, restricted licence banks and deposit-taking companies in Hong Kong, which are collectively known as authorized institutions (AIs). The Monetary Authority is also responsible for the designation and oversight of certain financial market infrastructures (FMIs).

However, the Monetary Authority cannot ensure, nor is the Hong Kong prudential regulatory framework designed to ensure, a zero-risk financial system. Instead, the Monetary Authority, as a resolution authority, seeks to ensure that, in the event of an AI becoming non-viable, its failure can be managed in an orderly manner. To this end, a resolution regime for financial institutions in Hong Kong has been established, under which the Monetary Authority is the resolution authority for AIs, amongst other types of institutions. To operationalise the resolution regime in Hong Kong, it is important to lay down resolution rules and policy standards, undertake resolution planning to remove impediments to AIs' resolvability and develop the HKMA's operational capability to resolve a failing AI. In order to carry out these tasks effectively, the HKMA adopts an internationally harmonised and coordinated approach.

REVIEW OF 2020

Overview of supervisory activities

In 2020, 186 off-site reviews were conducted covering a broad range of issues, including CAMEL rating assessment[1], corporate governance, risk management and fintech strategies. As part of the HKMA's continued efforts to promote stronger risk governance, 30 meetings were held with the boards of directors, independent non-executive directors or board-level committees of AIs. Furthermore, 30 tripartite meetings were held among the HKMA, the AIs and their external auditors.

Apart from off-site activities, the HKMA conducts regular on-site examinations supplemented with thematic reviews on areas assessed to be of higher risk. A total of 610 on-site examinations and thematic reviews were conducted during the year. Credit risk management remained a key focus of these examinations and reviews. Another major focus was operational risk and technology risk management under COVID-19. The HKMA also increased the number of on-site examinations and thematic reviews targeted at liquidity and market risk management. At the same time, specialist teams performed on-site examinations and thematic reviews of AIs' activities in securities, investment products, insurance and Mandatory Provident Fund (MPF)-related businesses.

Despite the pandemic, the HKMA maintained its supervisory intensity by adopting flexible methods in an agile manner to discharge its supervisory duties in an effective manner, including exercising flexibility around submission of returns and conduct of onsite examinations, stepping up collection of data to supplement onsite examinations, and making use of virtual meeting platforms.

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

Banking Stability

Table 1 contains an overall summary of the HKMA's supervisory activities in 2020.

Table 1 Summary of supervisory activities

	2020	2019
1 Off-site reviews and prudential interviews	**186**	196
2 Meetings with boards of directors, independent non-executive directors or board-level committees of AIs	**30**	26
3 Tripartite meetings	**30**	32
4 Culture dialogues	**7**	4
5 On-site examinations	**99**	104
Operational risk and technology risk management	25	12
AML/CFT controls	14	17
Liquidity risk management	6	0
Implementation of Basel capital adequacy framework	8	9
Capital planning	3	6
Market risk, counterparty credit risk and treasury activities	13	6
Securities, investment products, insurance and MPF-related businesses	17	23
Consumer protection	2	2
Deposit Protection Scheme (DPS)-related representation	10	12
Overseas examinations	1	17
6 Thematic reviews	**511**	301
Credit risk management and controls	50	50
Operational risk and technology risk management	108	76
AML/CFT controls	74	61
Model Risk Management	11	4
Sale of investment, insurance and MPF products	180	30
Consumer protection	51	42
Liquidity risk	25	23
Market risk	12	15
Total	**863**	663

Banking Stability

Supervision of credit risk

Credit growth and asset quality

Total loans increased by 1.2% in 2020, compared with a growth of 6.7% in 2019. Table 2 shows the breakdown of growth in loans and advances.

Table 2 Growth in loans and advances

% change	2020	2019
Total loans and advances	**1.2**	6.7
Of which:		
– for use in Hong Kong	**2.2**	7.7
– trade finance	**-6.2**	-0.7
– for use outside Hong Kong	**0.1**	5.8

Mainland-related lending decreased slightly by 0.2% to HK$4,553 billion in 2020 (Table 3).

Table 3 Growth in Mainland-related lending

% change	2020	2019
Total Mainland-related lending	**-0.2**	7.4
Of which:		
– Mainland-related lending (excluding trade finance)	**0.5**	7.1
– trade finance	**-10.8**	11

The asset quality of AIs deteriorated modestly, reflecting the impact of the COVID-19 pandemic. The banking industry's classified loan ratio increased from 0.57% to 0.90% during the year, remaining at a healthy level well below the long-run historical average of 1.8% since 2000. In terms of Mainland-related lending, the ratio also rose to 0.96% from 0.75% a year ago.

In view of the uncertainties arising from the COVID-19 pandemic causing significant headwinds to the economy, the HKMA conducted a deep-dive review of AIs' asset quality to assess emerging trends of deterioration. In particular, the HKMA stepped up its surveillance of large borrowers as well as vulnerable sectors in the current environment through collecting more granular data on banks' credit exposures at sectoral- and borrower-levels. An ad-hoc stress test analysis confirmed banks' resilience to the economic stress caused by the COVID-19 outbreak.

During the year, targeted and thematic examinations were conducted to evaluate the credit risk management practices of AIs in different areas, such as Mainland-related lending, interbank lending, and collateralised lending to private banking and wealth management customers.

Measures to alleviate cash flow pressure faced by customers

In response to the COVID-19 outbreak, the Banking Sector Small and Medium-sized Enterprise (SME) Lending Coordination Mechanism, established by the HKMA in October 2019, rolled out several rounds of relief measures for both corporate and retail customers with a view to encouraging banks to continue to support borrowers' financing needs to the extent permitted by prudent risk management principles. Most notably, the Mechanism launched the Pre-approved Principal Payment Holiday Scheme in May to defer all loan principal payments of eligible corporates by six months. After a six-month extension in November, the Scheme was further extended by six months in March 2021 to end-October 2021. Around 100 banks participated in the Scheme, covering 120,000 eligible corporate customers. By end-December, banks had approved over 58,000 cases for loan tenor extension and other forms of relief, involving an aggregate amount of over HK$740 billion. For personal customers, banks rolled out principal payment holiday programmes for residential mortgages, including those related to subsidised housing under the Home Ownership Scheme. Banks also offered relief loans to employees in hard-hit sectors, extended loan tenor for personal lending, and reduced charges on various forms of personal credit. As at end-December, banks had approved more than 28,000 cases of principal payment holiday for residential mortgages and other personal relief loans, amounting to over HK$44 billion.

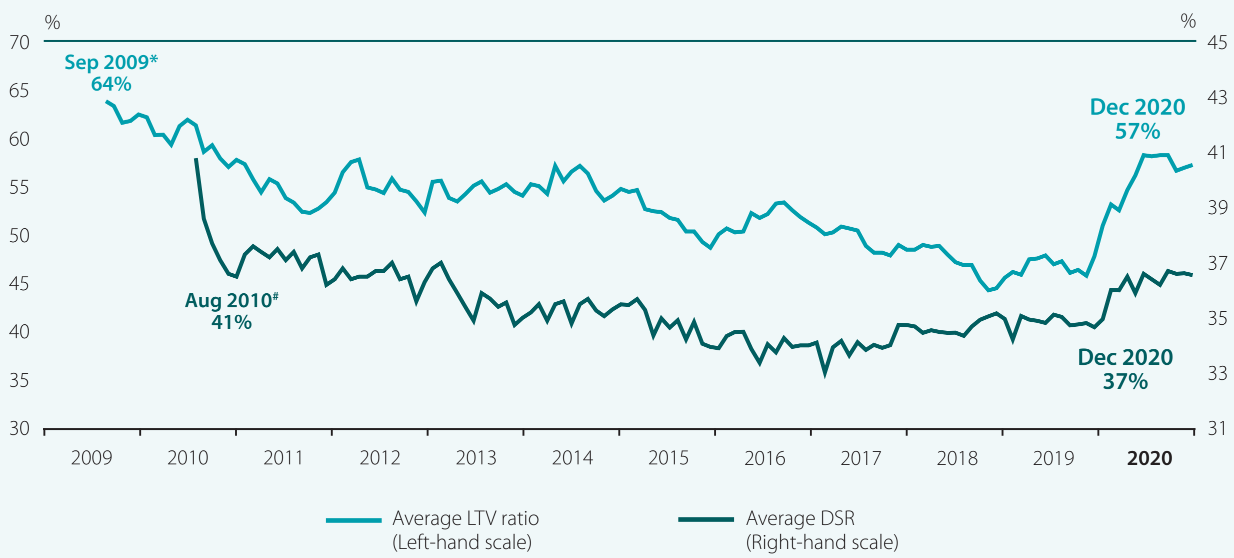
Banking Stability

Property mortgage lending

The successive rounds of countercyclical macroprudential measures introduced by the HKMA since 2009 have strengthened the risk management of banks and the resilience of the Hong Kong banking sector to cope with a possible abrupt downturn in the local property market. The average loan-to-value (LTV) ratio of new residential mortgage loans (RMLs) approved in December 2020 was 57%, compared with 64% in September 2009 before the countercyclical measures were first introduced. The increase in the average LTV ratio of newly approved RMLs in 2020 was primarily due to a larger proportion of RMLs with mortgage insurance, which generally had a higher LTV ratio. The average debt servicing ratio (DSR) of new mortgages remained low at 37% in December, compared with 41% in August 2010 when a cap on DSR was first applied (Chart 1).

In August, the HKMA relaxed the countercyclical macroprudential measures for mortgage loans on non-residential properties after taking into account factors such as the price trends and transaction volumes of these properties, economic fundamentals, and the external environment. The applicable LTV ratio caps for mortgage loans for these properties were adjusted upward by 10 percentage points, from 40% to 50% for typical cases.

Chart 1 Average LTV ratio and DSR of new RMLs approved



* Before the introduction of the first round of the HKMA's countercyclical measures on property lending
\# Introduction of a cap on DSR

Banking Stability

Supervision of operational and technology risk

In response to the outbreak of COVID-19 in early 2020, the HKMA undertook a series of steps to mitigate the outbreak's impact on banking operations. These steps included requiring AIs to review their business continuity plans (BCPs) and take appropriate precautionary measures to safeguard the health of their staff and customers, while maintaining essential banking services. The HKMA also reminded AIs to enhance communication with staff and customers, prepare for the possibility of infection cases at their premises, and develop BCPs for more severe but plausible risk scenarios. The HKMA maintained close dialogue with the industry and asked AIs to stay vigilant and keep their BCPs under review, having regard to the development of the COVID-19 pandemic and the Government's social distancing measures.

Following a holistic review of the Cybersecurity Fortification Initiative (CFI) and extensive industry consultation, the HKMA introduced CFI 2.0 in November. The CFI was enhanced to reflect the latest developments in overseas cyber practices. Specifically, recent international sound practices on cyber incident response and recovery were incorporated into the Cyber Resilience Assessment Framework (C-RAF). As regards the Professional Development Programme under the CFI, the certification list was expanded to include equivalent qualifications in major overseas jurisdictions. The HKMA also put forward a series of recommendations to the Hong Kong Association of Banks (HKAB) to make the Cyber Intelligence Sharing Platform more user-friendly. CFI 2.0 came into effect on 1 January 2021.

Smart Banking

All the eight virtual banks which obtained a banking licence in 2019 launched their business during the year, after rigorous testing and pilot trials in the Fintech Supervisory Sandbox. They adopted innovative technologies to provide new customer experience. One example is the use of big data analytics in the credit assessment of SME loans to expedite the loan approval process. To increase customer engagement and build brand loyalty, some virtual banks introduced gamification in their services such as time deposits and reward schemes.

As of the end of 2020:

8 virtual banks were in operation

A total of **420,000** accounts were opened with the virtual banks

Aggregate customer deposits with the virtual banks:
HK$15 billion

Banking Stability

Supervision of liquidity and market risk

The HKMA introduced a series of measures in April to ensure the continued smooth operation of the interbank market and the banking system amid the pandemic. These measures included clarifying the operational parameters of the HKMA Liquidity Facilities Framework, launching a temporary US dollar liquidity facility and reiterating the flexibility in the usage of liquidity buffers under the regulatory framework. The HKMA performed drills with AIs to ensure they were ready for utilising these measures when needed.

During the year, a round of thematic reviews was conducted to evaluate the robustness of AIs' contingency funding management for coping with liquidity shocks. The HKMA also assessed AIs' compliance with the regulatory requirements on the calculation of the Liquidity Coverage Ratio to ensure the prudence and accuracy of the inputs used for the calculation.

The HKMA conducted a round of thematic reviews to evaluate the effectiveness of AIs' risk management controls over treasury activities under remote booking arrangements. As algorithmic trading gained popularity in the banking industry, the HKMA promulgated a set of sound risk management practices for these activities based on the observations from earlier reviews.

On the transition away from the London Interbank Offered Rate (LIBOR), the HKMA continued to engage AIs in getting them prepared for the adoption of alternative reference rates (ARRs) and to request them to work closely with their counterparties to ensure a smooth transition. Apart from providing updates to the industry and conducting a regular survey to monitor the readiness of banks for the transition, the HKMA required AIs to endeavour to observe a set of transition milestones. Having regard to AIs' preparedness including their compliance with the transition milestones, the HKMA maintained bilateral dialogues with individual AIs to ensure that they were making reasonable progress. The HKMA also worked with industry associations to develop tools to facilitate AIs' preparation and help them impress upon their customers the need to make early preparations. Additionally, the HKMA took steps to raise public awareness of the need for transition through various channels including participating in speaking engagements as well as utilising electronic platforms such as the HKMA's website and social media.

Combating money laundering and terrorist financing (ML/TF)

The HKMA has acted quickly to reallocate supervisory resources and activities to minimize the impact of COVID-19 on AIs' AML/CFT work while also addressing the risks. Guidance was issued to AIs in April and July, in line with that of the global standard setter, the Financial Action Task Force (FATF), to clarify existing risk-based flexibility in our AML/CFT requirements, including the use of remote customer on-boarding, while reminding the need for vigilance to COVID-related financial crime risks. Case studies and alerts were shared globally (including cases provided by Hong Kong) in an FATF report in December.

Remote On-boarding and Customer Due Diligence

In the light of COVID-19 and the need for social distancing, remote customer on-boarding and digital delivery of financial services have become more important. In June, the HKMA shared with the banking industry key observations and good practices for remote customer on-boarding initiatives including assessment of the ML/TF risks to facilitate risk-based AML/CFT control measures as well as the monitoring of vulnerabilities associated with the product and delivery channel.

In September, the HKMA articulated key principles on remote on-boarding of corporate customers, on top of the guidance provided in relation to individual customers in February 2019.

The HKMA continues to engage with AIs closely on remote customer on-boarding including 26 discussions held in the Fintech Supervisory Chatroom and 17 pilot initiatives conducted through the Fintech Supervisory Sandbox during the year. To date, about 90% of retail banks have either fully launched or are planning to launch remote customer on-boarding, with more than 540,000 personal accounts opened remotely in 2020, compared with about 18,000 in 2019, a notable growth.

Banking Stability

The HKMA continued to collaborate closely with other stakeholders in Hong Kong's AML eco-system through the Fraud and Money Laundering Intelligence Taskforce (FMLIT)[2], which is similar to initiatives in other international financial centres. In 2020, FMLIT expanded its membership to reach 15 AIs from 10, and introduced short-term operational priorities, namely COVID-19 related deception and telephone deception. The FMLIT shared six alerts and typologies (e.g. face mask scams) with AIs and stored value facility (SVF) licensees to help enhance preventive measures as appropriate.

Amid growing geopolitical risks, the HKMA issued a circular in August to clarify its regulatory expectations in relation to financial sanctions. It also maintained close dialogue with AIs over business operational matters relating to the newly enacted National Security Law, and updated the industry Frequently Asked Questions (FAQs) in September.

The HKMA's risk-based supervision has been adapted to meet the challenges of remote working, new and emerging ML/TF risks arising from COVID-19 and new business models of virtual banks. During the year, the HKMA conducted 14 on-site examinations, including reviews of AIs' handling of data and information received from FMLIT; and 74 off-site reviews, including those of virtual banks.

COVID-19 has provided additional impetus to the industry Regtech adoption for AML/CFT. Follow-up work to the HKMA's 2019 AML/CFT Regtech Forum has continued unabated. The HKMA hosted a peer-to-peer sharing session on the use of network analytics to tackle mule account networks. It also issued the report "AML/CFT Regtech: Case Studies and Insights" jointly with an international consultant in January 2021 detailing case studies from a number of AIs that were early adopters of Regtech for AML/CFT applications, in order to provide comprehensive and end-to-end experience sharing to AIs at various stages of AML/CFT Regtech adoption.

AML/CFT Supervision in the Age of Digital Innovation

Proactive and targeted supervisory responses

Use of horizon scanning, data visualisation and analytics

Data-driven

Upgrade data governance and storage to improve data quality

Collaborative

Facilitate AIs and SVF licensees to accelerate AML/CFT Regtech adoption and results-oriented collaboration

People focused

Talent development in the right culture and upskilling with data and analytic capabilities

2 FMLIT is a public-private partnership for information sharing established in Hong Kong in May 2017. Since its launch and up to the end of December 2020, FMLIT delivered 638 intelligence-led suspicious transaction reports, leading to 299 arrests, HK$692 million being restrained or confiscated, and HK$106 million in losses prevented.

Banking Stability

The HKMA continued to enhance its approach in line with international standards and issued "AML/CFT Supervision in the Age of Digital Innovation" in September, setting out the objectives of the AML/CFT Surveillance Capability Enhancement Project and how the HKMA intended to strengthen the use of data and supervisory technology (Suptech) to make AML/CFT supervision more proactive, targeted and collaborative.

Supervision of wealth management and MPF-related businesses

The HKMA cooperates closely with other financial regulators in Hong Kong to provide guidance on and supervise AIs' practices in the sale of securities, investment products, insurance products and MPF schemes. The HKMA also maintains regular dialogue with other regulators through bilateral and multilateral meetings, as well as under the auspices of the Council of Financial Regulators, to ensure coordinated and effective supervisory actions. During the year, the HKMA conducted 17 on-site examinations, 180 thematic reviews and 14 analyses of surveys and returns of AIs, covering the sale of investment, insurance and MPF products, focusing in particular on high risk investment products, leveraged products as well as retirement planning and health insurance products enjoying tax benefits (Qualifying Deferred Annuity Policies, Voluntary Health Insurance Schemes and MPF Tax-deductible Voluntary Contributions). The HKMA and the Securities and Futures Commission (SFC) conducted concurrent thematic reviews of intermediaries' spread charges and disclosure of trading capacity and monetary benefits. The HKMA and the Insurance Authority (IA) held joint inspections on selected AIs, insurers and insurance intermediaries regarding their premium financing businesses. To better identify risks associated with the selling activities and areas of concern, the HKMA and the SFC refined the annual joint survey on the sale of non-exchange traded investment products.

To facilitate AIs' digital communication with customers, the HKMA worked with the SFC to provide guidance to the industry in September on the provision of trade documents and product documents to clients by electronic means. The HKMA also reviewed Supervisory Policy Manual (SPM) module SB-2 on "*Leveraged Foreign Exchange Trading*" and incorporated general principles on expected business conduct.

In the light of the development of the private wealth management industry, the HKMA worked with the SFC to provide guidance to the industry in September on the treatment for family offices in the assessment of the corporate structure and investment process of Corporate Professional Investors for exemption from the suitability and disclosure requirements. The HKMA and the SFC provided further guidance in December to streamline product due diligence and clarified a proportionate and risk-based approach in suitability assessment and disclosure processes especially for high-net-worth investors who are financially sophisticated. The HKMA also provided guidance, in the form of FAQs, to AIs in December to facilitate their implementation of the refined investor protection measures on the sale of investment, insurance and MPF products promulgated in 2019. In line with the spirit of enhancing customer experience while according protection to customers, and following a risk-based approach, the HKMA provided guidance to registered institutions (RIs) in July to streamline the sale and distribution process for eligible plain vanilla and low-risk retail bonds issued by government and related organisations. Furthermore, the HKMA launched an industry consultation in July on a proposal to enhance the regulation and supervision of trust business in Hong Kong, including a Code of Practice for Trust Business, to promote treating customers fairly and customer-centric culture in trust business.

Banking Stability

In respect of the insurance-selling activities of AIs, the HKMA worked closely with the IA to facilitate selling of insurance products via non-face-to-face (non-F2F) channels while safeguarding protection to customers. Guidance was also provided in October to AIs on expected standards in handling life insurance policy replacement in light of supervisory experience. Following the completion of a mystery shopping programme, the HKMA shared with the industry in September the key observations and good practices noted on retail banks' selling practices in respect of investment and insurance products.

During the year, the HKMA processed seven applications for registration as an RI and addition of regulated activities under the Securities and Futures Ordinance (SFO). It granted consent to 209 executive officers responsible for supervising the securities activities of RIs and conducted background checks on 5,006 individuals whose information was submitted by RIs for inclusion in the register maintained by the HKMA.

Moreover, pursuant to the new Memorandum of Understanding (MoU) between the Monetary Authority and the IA under the new regulatory regime for insurance intermediaries that came into operation in September 2019, the HKMA put in place procedures and provided comments to the IA on the application of one AI for an insurance agency licence. The HKMA also provided comments on eight AIs which are deemed licensed insurance agencies to facilitate the IA's assessment of their insurance agency licence applications during the year.

Following the joint announcement in June by the People's Bank of China, the HKMA and the Monetary Authority of Macao on the launch of the Wealth Management Connect Pilot Scheme (WMC Scheme) in the Guangdong-Hong Kong-Macao Greater Bay Area, the HKMA together with the relevant authorities developed and consulted the industry on the proposed implementation details.

Other supervisory activities

The Banking Supervision Review Committee considered three cases concerning the granting of banking licences in 2020 (see Table 4 for details).

During the year, the HKMA commissioned 18 reports under section 59(2) of the Banking Ordinance (BO), which required AIs to appoint external professional firms to report on the effectiveness of their controls in specified areas of operation. Seven of these reports covered credit risk management, another four covered the institution's overall risk governance framework, and the remaining reports were related to areas such as compliance with the BO and AML/CFT controls.

In 2020, there were no incidents reported by AIs involving a breach of the requirements in the BO relating to the capital adequacy or liquidity ratio. There were 50 breaches of other provisions of the BO, mostly related to AIs' reporting obligations under the legislation. These breaches did not affect the interests of depositors and were promptly rectified by the AIs.

During the year, the CAMEL Approval Committee completed a review of the CAMEL ratings of all the 194 AIs. No AIs appealed against the Committee's decisions.

Table 4 Summary of other supervisory activities

		2020	2019
1	Cases considered by the Banking Supervision Review Committee	**3**	18
2	Reports commissioned under section 59(2) of the BO	**18**	18
3	Approval of applications to become controllers, directors, chief executives or alternate chief executives of AIs	**226**	282

Banking Stability

International cooperation

Cooperation with overseas supervisors

The HKMA participated in 49 college-of-supervisors meetings organised by the home supervisors of 20 banking groups with significant operations in Hong Kong. Most of these meetings were held in the form of virtual meetings amid the COVID-19 pandemic. Apart from the regular exchange of supervisory issues, the meetings focused on the impact of the COVID-19 pandemic on banks' financial positions and operational resilience.

The HKMA is a member of each of the Crisis Management Groups (CMGs) for 12 global systemically important banks (G-SIBs) attended by the relevant home and host authorities. At the regional level, the HKMA organises the Asia CMG for a G-SIB with its Asia-Pacific headquarters in Hong Kong and is a member of the Asia-Pacific Recovery and Resolution Planning College for two other G-SIBs where resolution-related topics are addressed.

Bilateral meetings were held during the year with banking supervisors from Australia, the European Union, India, Japan, Mainland China, Malaysia, Singapore, Switzerland, Thailand, the UK and the US. There were also regular exchanges with authorities in other jurisdictions on institution-specific issues and developments in financial markets.

Participation in international and regional forums

The HKMA participates in a range of international and regional forums for banking supervisors. It is a member of the Basel Committee on Banking Supervision (Basel Committee) and its governing body, the Group of Governors and Heads of Supervision. In 2020, the HKMA was represented on various Basel Committee working groups, including the Policy Development Group (PDG), the Macroprudential Supervision Group, the Supervision and Implementation Group (SIG), the high-level Task Force on Climate-related Financial Risks (TFCR) and the AML/CFT Expert Group. The HKMA was also a member of several Expert Groups under the (i) PDG, including the Working Group on Capital, the Credit Risk Group, the Market Risk Group, the Operational Resilience Working Group, the Working Group on Liquidity, the Large Exposures Group and the Working Group on Disclosure; and (ii) SIG, including the Stress Testing Network, the Task Force on Financial Technology and the Colleges Monitoring Network. In addition, the HKMA served as the chair of the SIG. The HKMA also participated in the joint Working Group on Margin Requirements formed by the Basel Committee and the International Organization of Securities Commissions (IOSCO).

Following the Basel Committee's revised organisation structure which took effect from January 2021, the HKMA serves as a co-chair of the Policy and Standards Group and the chair of the Pillar 2 Expert Group. The HKMA is a member of the Risks and Vulnerabilities Assessment Group, Supervisory Cooperation Group, and Policy and Standards Group. The HKMA is also a member of the TFCR and various Expert Groups, including Accounting and Audit, Anti-money Laundering, Capital and Leverage Ratio, Credit Risk and Large Exposures, Disclosure, Financial Technology, Liquidity, Margin Requirements, Market Risk, Operational Resilience, Pillar 2 and Stress Testing. The HKMA also participates in the Regulatory Consistency Assessment Programme (RCAP) Review Task Force, which is set up to consider whether further improvements to RCAP should be made to ensure that the objective of full, timely and consistent implementation of Basel standards is met in the coming years.

The HKMA is a member of the Network of Central Banks and Supervisors for Greening the Financial System and joined the International Platform on Sustainable Finance in December, representing Hong Kong jointly with the SFC. It also participates in the Financial Stability Board (FSB) LIBOR Drafting Team which focuses on supervisory issues associated with LIBOR transition.

On Financial Consumer Protection, HKMA participates actively in the work of the G20/OECD Task Force on Financial Consumer Protection, which supports the implementation of the G20 High-level Principles on Financial Consumer Protection and develops the Effective Approaches for the applications of these principles, taking into account operations in an increasingly digital environment.

On AML/CFT, in addition to the AML/CFT Expert Group of the Basel Committee, the HKMA continues to participate actively in the FATF and the Asia/Pacific Group on Money Laundering and draw AIs' attention to the latest international regulatory development. In February, the HKMA commenced a two-year co-chairmanship in the Evaluation and Compliance Group of the FATF, overseeing its mutual evaluation programme and also contributed a financial expert assessor to the evaluation of New Zealand.

At the regional level, the HKMA is a member of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP)[3], 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 in the EMEAP Working Group on Banking Supervision (WGBS), the HKMA is the champion of the Interest Group on Liquidity (IGL). During the year, the IGL exchanged views and shared experience regarding the implementation of Basel III liquidity standards in the EMEAP jurisdictions amid the COVID-19 pandemic. The HKMA is also the champion of the Interest Group on Sustainable Finance, which aims to promote information sharing on the management of climate-related risks faced by banks in the region. In addition, during the year the HKMA was the chair and served as the secretariat of the Focused Meeting on Resolution (FMR), a resolution-specific forum under the WGBS. The FMR supported knowledge sharing and discussion among regional authorities in relation to resolution in a cross-border context. The HKMA is now the chair of the Study Group on Resolution (SGR) which builds on the work of the FMR. See "*International policy and regional cooperation*" on page 87 for more details.

Basel Committee Regulatory Consistency Assessment Programme

The Basel Committee conducts an RCAP to monitor, assess and evaluate its members' implementation of the Basel standards. The HKMA participated in the assessment of Japan's large exposures standards which has been put on hold since early 2020 due to COVID-19.

3 EMEAP is a cooperative organisation of central banks and monetary authorities in the East Asia and Pacific region.

Banking Stability

Implementation of Basel Standards in Hong Kong

Capital standards

In 2020, the Banking (Capital) (Amendment) Rules 2020 were made to implement, with effect from 30 June 2021, *The Standardised Approach for Measuring Counterparty Credit Risk Exposures* (SA-CCR) and *Capital Requirements for Bank Exposures to Central Counterparties* (CCP standard).

Consequential changes to the leverage ratio framework and disclosure requirements were also being made to reflect the implementation of SA-CCR and CCP standard, together with other updates issued by the Basel Committee, such as those in relation to the revised treatment of collateral in client cleared derivatives for leverage ratio calculation.

Regarding *Capital Requirements for Banks' Equity Investments in Funds* (EIF standard), further to the consultation conducted in 2019, the HKMA issued in November for consultation another set of proposed provisions covering all approaches for credit risk calculation. The proposed provisions also contain refinements made in light of the comments received in the 2019 consultation and subsequent updates from the Basel Committee on the EIF standard.

Preparatory work was also in progress for implementing the revised capital standards contained in the *Basel III: Finalising Post-crisis Reforms* published by the Basel Committee in December 2017 (Basel III final reform package), covering those in relation to credit risk, operational risk, output floor, and the leverage ratio. To provide additional capacity for banks and supervisors to respond to the immediate financial stability priorities resulting from the impact of COVID-19 on the global banking system, the implementation of the Basel III final reform package was deferred internationally by one year to 1 January 2023. Nevertheless, to allow more time for the required policy deliberation and rule-making, the HKMA initiated industry consultation of detailed implementation proposals in November, as informed by a local quantitative impact study (QIS) conducted in 2019.

Further to the industry consultation in 2019 on Hong Kong's proposed local implementation approach for the revised "*Minimum Capital Requirements for Market Risk*", a local QIS was launched in March 2020 to assess the impact of the revised market risk framework on AIs and to inform policy decisions on local implementation.

On 8 July 2020, the Basel Committee issued the final revision of the CVA risk framework "*Targeted Revisions to the Credit Valuation Adjustment Risk Framework*". The HKMA published a consultation paper on its implementation proposal for Hong Kong on 15 December 2020.

On 16 March 2020, the HKMA reduced the jurisdictional Countercyclical Capital Buffer for Hong Kong from 2.0% to 1.0% with immediate effect to allow banks to be more supportive of the domestic economy, in particular those sectors and individuals expected to be most affected by COVID-19.

In line with the Basel Committee's framework for dealing with domestic systemically important banks (D-SIBs), the HKMA announced in December an updated list of D-SIBs for 2021 and their corresponding higher loss-absorbency capital requirements.

Improving Supervisory Policy Framework

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

The HKMA has implemented the global margin and risk mitigation standards since 1 March 2017 for AIs involved in non-centrally cleared OTC derivatives transactions. Following the announcement made by the Basel Committee and IOSCO on 3 April 2020 to alleviate the impact of COVID-19 on the banking system, the HKMA revised SPM module CR-G-14 on *"Non-centrally Cleared OTC Derivatives Transactions — Margin and Other Risk Mitigation Standards"* to defer the commencement dates of the final two implementation phases of initial margin requirements by an additional year to 1 September 2021 and 1 September 2022 respectively, on top of the one-year extension announced by the Basel Committee and IOSCO in July 2019 to support a smooth and orderly implementation of the margin requirements. The HKMA will continue to monitor AIs' implementation of the remaining phases and coordinate with other member jurisdictions of the Basel Committee and IOSCO Working Group on Margin Requirements on implementation and market developments.

Updating other supervisory policies and risk management guidelines

The HKMA pressed ahead with various policies and guidelines in 2020, including:

- In June — finalised and issued the revised SPM modules RE-1 on *"Recovery Planning"* and CA-G-1 on *"Overview of Capital Adequacy Regime for Locally Incorporated Authorized Institutions"* as statutory guidelines under section 7(3) of the BO. The revisions to RE-1 serve to reflect developments in international and local standards and practices in the recovery planning of AIs, and the revisions to CA-G-1 mainly serve to reflect the current capital regime in Hong Kong, particularly in relation to the HKMA's supervisory practices and expectations concerning institutions' self-assessment of proposed capital instruments to be included within their capital base.

- In August — finalised and gazetted the revised SPM module LM-1 on *"Regulatory Framework for Supervision of Liquidity Risk"*, mainly to reflect changes consequential to the commencement of the Banking (Liquidity) (Amendment) Rules 2019.

- In October — consulted the industry on some proposed revisions to SPM module CA-B-2 on *"Systemically Important Banks"* with the aim of improving the assessment of AIs' complexity in our D-SIBs identification process and updating various sections of the SPM module to reflect recent developments.

- In December — issued for industry consultation the proposed revisions to SPM module CS-1 on *"Group-wide approach on supervision of locally incorporated authorized institutions"*. The revisions primarily sought to reflect the HKMA's latest supervisory practices and incorporate relevant principles in international standards concerning the supervision of financial conglomerates.

Banking Stability

Compliance with regulatory regime for over-the-counter derivatives market

The HKMA monitors closely the compliance of AIs and approved money brokers (AMBs) based on the mandatory reporting, clearing, and related record-keeping requirements on OTC derivatives transactions as stipulated in the SFO. Close dialogue is maintained with AIs, AMBs and other industry participants on various reporting issues to facilitate their compliance with the relevant requirements arising from OTC derivatives market developments and evolving international standards.

Balanced and responsive supervision

Since its introduction in 2017, the Balanced and Responsive Supervision initiative has facilitated the HKMA's engagement with the banking industry to optimise supervisory policies and processes for an appropriate balance between supervisory effectiveness and sustainable market development. In 2020, the HKMA clarified its supervisory expectations on AIs' outsourcing arrangements and remote customer on-boarding initiatives, and provided an update on the proposed mandatory reference checking scheme to mitigate the risk of hiring individuals with a history of misconduct. Taking into account the banking sector's views on balancing compliance effectiveness, market developments and customer experience, the HKMA also provided guidance on banks' compliance efficiency in cross-sector fintech projects. In response to the increasing use of technology in providing banking services, particularly amid COVID-19, the HKMA initiated rounds of interactive dialogue with the banking sector on managing the associated operational challenges, especially in the selling of investment and insurance products via non-F2F channels. The discussions have deepened the understanding between the HKMA and banks for the sustainable development of the banking sector.

Accounting standards

Regular dialogues were conducted between the HKMA and the Banking Regulatory Advisory Panel of the Hong Kong Institute of Certified Public Accountants on topics of common interest. These included approaches adopted by AIs on expected credit losses estimation under COVID-19 and the related responses of AIs' external auditors, international and domestic developments on new or revised accounting, auditing and financial reporting standards and their implications for banks, as well as major international and domestic banking regulatory developments.

Green and sustainable banking

During the year, in accordance with the three-phased approach to promote green and sustainable banking, the HKMA developed a common assessment framework with the banking industry to assess the greenness baseline of banks, and the first round of assessment covering 47 AIs was completed. Insights from the assessment were published in the *HKMA Quarterly Bulletin* in September.

As part of Phase II of the approach, a white paper was published in June, which outlined the HKMA's initial thinking on supervisory expectations and formed the basis for further engagement with the industry. Following a series of discussions with selected major banks, the HKMA issued a circular in July to share with AIs a range of practices for managing climate risks, to provide AIs with reference for developing their climate risk management framework.

The HKMA invited AIs to participate in a pilot exercise on climate risk stress test (CRST) to be undertaken in 2021. The CRST aimed to assess the climate resilience of the banking sector and to facilitate the capacity building of AIs for measuring and managing climate risks. A set of guidelines for the exercise was shared with interested AIs for their preparation for the exercise.

For more details about the HKMA's policy framework for green and sustainable banking, see the *Corporate Social Responsibility* chapter.

Resolution

In 2020, the HKMA continued to advance work to operationalise the Hong Kong resolution regime for banks. Progress has been made in establishing resolution standards, undertaking resolution planning and developing resolution execution capability. Throughout the year, the HKMA continued to contribute to cross-border cooperation on resolution through institution-specific engagements such as the CMGs for G-SIBs as well as through international and regional fora including the FSB Resolution Steering Group (ReSG) and the EMEAP FMR and SGR.

Resolution standards

The HKMA continues to formulate policy standards with which AIs need to comply in order to enhance their resolvability. One of the potential impediments to resolvability on which the HKMA has been working is the risk to cross-border effectiveness of resolution arising from the early termination of financial contracts that are governed by non-Hong Kong law. To this end, the HKMA consulted on the policy proposals for making rules under the Financial Institutions (Resolution) Ordinance (FIRO) on contractual stays for AIs on 22 January. In line with the relevant FSB principles in this regard, the proposals require the adoption of an appropriate provision in certain financial contracts governed by non-Hong Kong law, such that the parties to the contract agree to be bound by a suspension of termination rights (a "stay") that may be imposed by the Monetary Authority as a resolution authority under the FIRO. On 31 December, the HKMA released the conclusion of the consultation and consulted the industry on the draft text of the rules. Following industry consultation, the rules are expected to be introduced into the Legislative Council for negative vetting in the 2020/2021 Legislative Session.

Operational continuity in resolution (OCIR) is another potential impediment to resolvability on which the HKMA made progress during the year towards policy development. On 1 February 2021, the HKMA issued for industry consultation a draft of the FIRO Code of Practice (CoP) chapter OCIR-1 on "*Resolution Planning — Operational Continuity in Resolution*". The draft chapter explains the Monetary Authority's policy in relation to OCIR and sets out the Monetary Authority's expectations regarding the *ex-ante* arrangements AIs should put in place, in line with the relevant FSB guidance in this regard, to secure the continuity in resolution of services that are essential to the continued performance of critical financial functions as well as to support post-stabilization restructuring in a timely manner.

Advancing Resolution Priorities amid the COVID-19 Pandemic

Resolution planning fosters effective crisis preparedness for maintaining financial stability including continuity of critical financial functions performed by banks. In times of uncertainty, it is particularly important for the ongoing work to enhance resolvability of AIs and cross-border coordination to continue.

Despite the COVID-19 pandemic, the HKMA carried on with its resolution priorities at a steady pace. Flexibility, for example extension of information submission deadlines, was offered to AIs as part of resolution planning programmes as appropriate to alleviate their temporary operational burden without losing impetus. The CMGs and Resolution Colleges for G-SIBs conducted meetings virtually and continued to be fora for timely and effective cross-border coordination and information exchange.

In addition, the HKMA has contributed to the related international responses and discussions, including the FSB's regular monitoring of the impact of COVID-19-linked market disruption on the issuance, receptivity and pricing of total loss-absorbing capacity (TLAC) eligible instruments; the ReSG-Standing Committee on Supervisory and Regulatory Cooperation joint meeting on crisis management preparedness; and the Bank for International Settlements' Committee on the Global Financial System workshop on bail-inable debt.

Banking Stability

Resolution planning

The HKMA continued to advance resolution planning for each of the six D-SIBs and engaged other locally-incorporated AIs with total consolidated assets above HK$300 billion to provide the core information required for resolution planning (Chart 2), marking the commencement of resolution planning for banks beyond D-SIBs.

Chart 2 Status of the HKMA's key resolution planning programmes with AIs

	1 Core information gathering	2 Resolution strategy setting	3,4 Ongoing resolvability assessment and removal of impediments (e.g. LAC and OCIR)
D-SIBs	Regular submission	Determined	Continued to advance in 2020
Other locally-incorporated AIs with total assets > HK$300 billion	First submission in 2020		

Through resolution planning programmes, the HKMA works with the D-SIBs to implement the changes needed to address identified impediments to their orderly resolution. In particular, the D-SIBs are building up a new layer of loss-absorbing capacity (LAC) resources by the issuance of capital and non-capital LAC debt instruments to facilitate their loss absorption and recapitalisation in case of failure. Some D-SIBs are progressing their approaches to non-pre-positioned LAC resources, and all D-SIBs are now making periodic public disclosures of their LAC positions and instruments.

Some of the D-SIBs are also developing new capabilities as part of group-wide programmes to enhance resolvability. This has involved a wide spectrum of actions, such as functional design and development of models and processes for valuations in resolution, assessment of the criticality of and relationship with financial market infrastructure and review of capabilities for estimating and reporting liquidity needs in resolution. The operational readiness of some of the arrangements has been demonstrated by means of scenario testing of operational services, mapping and playbooks as well as cross-border drills of contingency arrangements for access to payment clearing.

Cross-border cooperation is an important component of resolution planning for G-SIBs given the international nature of their businesses and operations. The HKMA led the regional resolution planning for a G-SIB with its Asia-Pacific headquarters in Hong Kong, organising the Asia CMG and driving the work to enhance resolvability for the G-SIB's Asia resolution group.

During the year, the HKMA participated in the cross-border resolution planning of 14 G-SIBs through CMGs and Resolution Colleges. As part of this work, the HKMA shared updates on policy development, contributed to the FSB's sixth resolvability assessment process for these G-SIBs and worked with the relevant authorities to operationalise home-host coordination arrangements. For example, the HKMA took part in the initial discussions on the management and deployment of unallocated TLAC resources within groups and the development of playbooks on resolution execution.

HKMA's resolution execution capability

The HKMA continued to enhance its capability to execute resolution. This included work to refine its internal frameworks for effective cross-departmental coordination in managing at-risk AIs, operationalise the Contingent Term Facility and Resolution Facility under the HKMA's Liquidity Facilities Framework for banks, and develop local mechanics to execute transfer stabilization options.

In addition, the HKMA made progress with the establishment of a Resolution Advisory Framework, executing a number of framework agreements for specific services and continuing discussions with the other successful tenderers. It also advanced the development of cross-sectoral coordination arrangements for crisis management and resolution under FIRO.

International policy and regional cooperation

The HKMA is actively involved in the implementation of resolution reforms through its membership of the FSB. In the FSB's *2020 Resolution Report: "Be prepared"*, the FSB states that G-SIBs' progress towards resolvability was broadly satisfactory, while highlighting that important work remains on technical aspects. See *"HKMA's Involvement in International Resolution Policy Work in 2020"* on page 88 for more details.

At the regional level, as the Chair and Secretariat of the EMEAP FMR, the HKMA supported a review which examined whether a more permanent resolution forum could be usefully established within EMEAP. The 25th EMEAP Governors meeting endorsed the FMR's review proposal to establish the SGR. The SGR is a resolution-specific forum within EMEAP and builds on the good work of the FMR. The SGR supports knowledge sharing and discussion among regional authorities in relation to resolution in a cross-border context. The HKMA was subsequently appointed as the Chair of the SGR (see page 81 for further information on EMEAP work). The HKMA continued to engage with relevant stakeholders with a view to promoting better understanding of the resolution regime and the related operational arrangements in Hong Kong. In 2020, the HKMA took part in a number of virtual events, for example those organised by the Bank for International Settlements' Financial Stability Institute and the South-East Asian Central Banks Centre, and provided speakers on a range of topics such as liquidity and funding in resolution and crisis preparedness.

Banking Stability

HKMA's Involvement in International Resolution Policy Work in 2020

Effective resolution requires internationally harmonised resolution policies and standards, given the cross-border nature of many large financial institutions. This is pertinent to Hong Kong as a material host of operations of all G-SIBs[4].

To reflect Hong Kong's unique role as a key host jurisdiction of G-SIBs and internationally active banking groups as well as a regional home for the resolution entities of some of these banking groups, the HKMA takes an active part in formulating and implementing international resolution policy standards. It has been contributing primarily through its membership of the FSB ReSG and the FSB ReSG's Cross-Border Crisis Management (CBCM) Group for Banks.

The HKMA is a member of a number of workstreams of the FSB ReSG's CBCM Group for Banks, including:

- The TLAC Technical Expert Group, which aims to ensure continued effective implementation of the FSB TLAC Standard[5];
- The Bail-in Execution workstream, which is developing a practices paper to identify good practices based upon stocktake of mechanisms across jurisdictions and engagement with relevant market infrastructure and authorities; and
- The CMG Good Practices workstream, which aims to draw on the ReSG's stocktake of CMG operations in 2020 and members' experiences during the COVID-19 pandemic to identify good practices as regards the efficient operation of CMGs, coordination to enhance banks' resolvability, and operationalisation of home-host coordination arrangements.

In 2020, the HKMA also participated as a member of the FSB's working group to evaluate the effects of the "too-big-to-fail" reforms for systemically important banks. This work aims to examine the extent to which post-crisis reforms, including resolution policies and planning, have had the effect of reducing the systemic risk and moral hazard associated with SIBs. A report of this evaluation was published for consultation in June, with the final report published in April 2021.

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4 See https://www.fsb.org/wp-content/uploads/P111120.pdf for the 2020 list of G-SIBs.

5 For more detail on the FSB's latest progress and technical work on TLAC, in particular on unallocated TLAC, see Section 2 of the FSB's *2020 Resolution Report: "Be prepared"* (https://www.fsb.org/wp-content/uploads/P181120.pdf).

Bank consumer protection

Code of Banking Practice

The industry's overall compliance with the Code of Banking Practice remains satisfactory. According to the results of the self-assessment exercise covering 2019, almost all AIs as well as their subsidiaries and affiliated companies reported full or nearly full compliance[6], while a few AIs have taken prompt remedial actions to rectify areas of non-compliance. In December, at the HKMA's request, the Code of Banking Practice Committee commenced a review of the Code to enhance protection to consumers, particularly in the light of the increasingly digitalised channels for delivering financial services.

Consumer protection in the digital age

In order to strike a balance between innovation and consumer protection, AIs should adopt a risk-based approach and implement consumer protection measures that are commensurate with the risks involved. The HKMA introduced in September enhanced disclosure measures in the form of a "double reminder" in respect of the digital platforms where retail individual customers and SMEs apply for AIs' unsecured loan and credit card products, in order to provide borrowers with prominent and adequate information as well as adequate chance to consider the implications of their borrowing.

Consumer protection in respect of reform of interest rate benchmarks

Further to earlier reminders on the need for early preparations for the transitions to ARRs, the HKMA issued a circular in October to remind AIs to uphold customer protection principles in line with the Treat Customers Fairly Charter and other applicable requirements (e.g. Code of Banking Practice) throughout the processes of the reform and transition of interest rate benchmarks, and to develop robust customer communication programmes for consumer education and outreach.

6 With five or fewer instances of non-compliance.

Banking Stability

Investor and Consumer Protection under COVID-19

The COVID-19 pandemic and the associated social distancing measures has increased the willingness of bank customers to make use of digital banking channels on the one hand while posing great challenges to the banking industry in ensuring protection to customers using such channels on the other hand. In response, the HKMA has provided various supervisory guidance and regulatory flexibilities to banks to facilitate their operations and continued services to customers while safeguarding protection to investors and consumers.

In line with the social distancing measures to avoid personal contacts during the selling process of investment and insurance products while ensuring customers' interests are protected, the HKMA worked closely with the IA to introduce two phases of temporary facilitative measures in February and March to allow non-F2F distribution of certain insurance products with compensating measures implemented. The HKMA also collaborated with the IA in reviewing various proposals on non-F2F distribution of insurance products involving AIs under Insurtech Sandbox of the IA. In view of the increasing popularity in the use of video conferencing tools for the sale of long-term insurance products during the pandemic, the HKMA issued a circular in August to remind AIs about the relevant regulatory requirements. As regards the distribution of investment products, the HKMA provided supervisory guidance and clarifications in February to March on the use of non-F2F channels for providing investment services (such as the taking of client orders under work-from-home arrangements of staff), and reminded banks to put in place compensating measures and controls. In view of the market volatility amid COVID-19, the HKMA issued reminders of important investor protection measures, especially those relating to higher risk products and leveraged transactions.

Taking into account the difficulties faced by customers being affected by the economic downturn amid the pandemic, the HKMA issued guidance to remind banks to be responsive and flexible in considering the needs of these customers, and to provide prominent information about the specific relief measures to the customers concerned. In addition, the HKMA reminded AIs to allocate adequate resources to support the handling of customer enquiries and complaints. In view of the possible delay in AIs' delivery of account statements and other communications to customers due to disruptions in postal services, the HKMA provided supervisory guidance in the first quarter of the year, requiring AIs to provide flexibility to customers who may need more time to respond to delayed customer communications, particularly those involving financial charges. The HKMA also reminded the AIs to liaise with the affected customers to arrange alternative delivery channels where appropriate.

Amid a rise of scams and other cyber security threats globally during the pandemic, the HKMA stepped up consumer education through issuing four posts on social media platforms like Facebook and LinkedIn from June to August, urging members of the public to stay vigilant to possible fraud scenarios where victims are induced to open files with malicious programmes, transfer funds to third party accounts, and/or provide digital keys (e.g. bank account number and e-banking login credentials) and sensitive personal information.

An example of educational message through social media reminding members of the public of possible fraud scenarios.

Last but not least, as AIs have activated their BCPs (including split team and work-from-home arrangements) under the pandemic, the HKMA has taken a pragmatic approach regarding AIs' submission of supervisory returns and surveys, as well as their compliance with certain regulatory and licensing requirements.

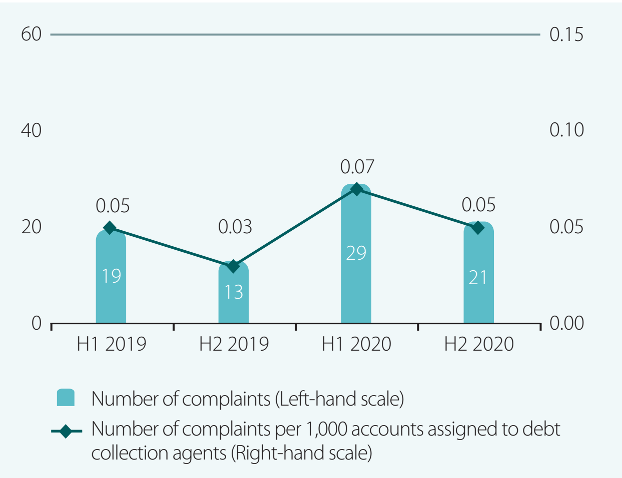
Engagement of intermediaries by authorized institutions

Various measures were introduced to further protect the interests of bank customers and reduce potential risks to the reputation of the banking industry arising from possible malpractices undertaken by fraudulent lending intermediaries. In particular, the HKMA reminded the public to stay alert to bogus phone calls. Retail banks' hotlines have been widely and effectively used by the public to verify callers' identities, with a total of over 18,000 enquiries received during the year.

Customer complaints relating to debt collection agents employed by authorized institutions

The number of complaints received by AIs about their debt collection agents increased to 50 from 32 in 2019 (Chart 3). The HKMA will continue to monitor AIs' engagement with debt collection agents.

Chart 3 Complaints received by AIs about their debt collection agents



Credit data sharing

The HKMA continued to follow up on a security incident that took place in November 2018 concerning security loopholes in the online credit reference enquiry service offered by TransUnion, a consumer credit reference agency (CRA) in Hong Kong. The suspended online service was resumed by phases in 2020 after TransUnion enhanced its information security arrangement in compliance with the requirements in the enforcement notice issued by the Privacy Commissioner for Personal Data (PCPD) and completed independent assessments on its online authentication and data security system at the request of the HKMA and HKAB.

Meanwhile, the HKMA continued to work with HKAB, the DTC Association (DTCA) and the Hong Kong S.A.R. Licensed Money Lenders Association Ltd. on the proposal to introduce more than one consumer CRA in Hong Kong, with a view to enhancing the service quality of consumer CRA and reduce the operational risk of having only one commercially run service provider in the market, particularly the risk of single point of failure.

Addressing the risks of hiring of individuals with misconduct

The HKMA conducted a consultation on the proposed implementation of a Mandatory Reference Checking Scheme to address the "Rolling Bad Apples" phenomenon (i.e. individuals who engaged in misconduct during their previous employment but subsequently managed to obtain employment elsewhere without disclosing their earlier misconduct to the new employer) in the local banking sector. The industry generally considered the consultation proposals useful in addressing the issues. Responses received from the consultation will provide the basis for developing more detailed proposals for the implementation of the Scheme.

Banking Stability

Bank Culture

The HKMA continued to proceed with the "Bank Culture Reform" which was initiated in March 2017, with a view to cultivating sound culture and values in banks. The HKMA first commenced a self-assessment exercise of bank culture in 2019, which covered 30 banks (including all major retail banks and selected foreign bank branches). Based on observations from this exercise, the HKMA published a *"Report on Review of Self-assessments on Bank Culture"* in May 2020.

As there is no one-size-fits-all approach when it comes to culture, all AIs are encouraged to pay attention to the common themes identified in the Report; to make reference to the range of practices; and to consider whether these practices are effective in driving cultural changes based on their desired culture, values and behavioural standards.

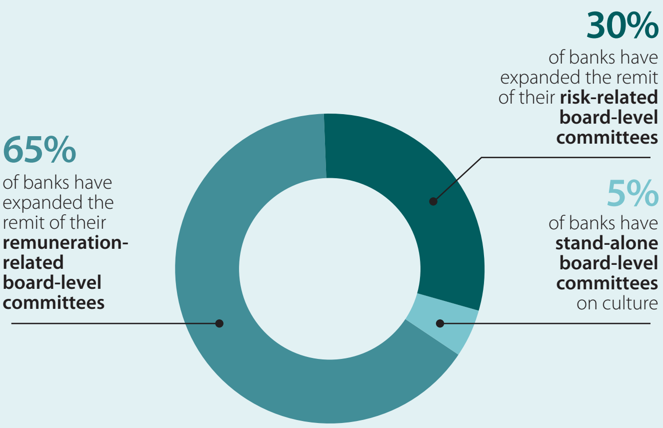
The Report set out a range of practices across the selected banks under each of the three pillars: (1) governance, (2) incentive systems, and (3) assessment and feedback mechanisms as a handy reference for AIs to further devise their own culture enhancement measures. See Table 5 for examples.

Table 5 Examples of practices adopted by banks in promoting sound culture

Governance

- All locally incorporated banks covered in the self-assessment exercise have a board-level committee, chaired by an independent non-executive director, to oversee culture-related matters.

Figure 1 Use of board-level committees to oversee culture



- Common methods of "tone-from-the-top" communications include town hall meetings by management; newsletters to staff; and training exercises (classroom or e-learning). Some banks use methods such as guidance for staff dealing with "grey areas", creative videos, and summary sheets that can be an effective means of ensuring the bank's desired culture, values and behavioural standards flow through the different levels of staff.

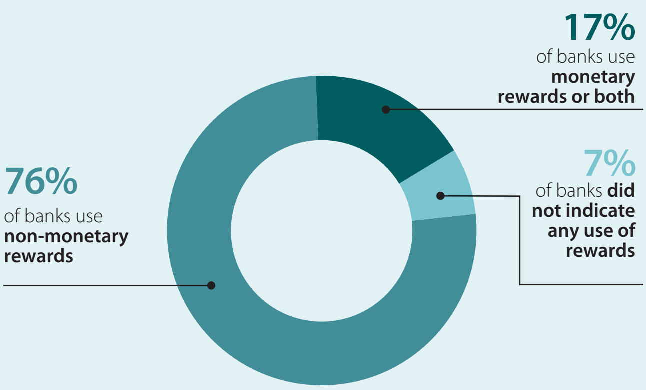
Incentive systems

- There was a greater use of a balanced scorecard approach by banks that would consider "what" (financial factors) and "how" (non-financial factors) when determining variable remuneration for staff. All banks have incorporated certain non-financial indicators (including behavioural indicators) as part of the performance assessment of staff.

Figure 2 Use of non-financial indicators to assess staff performance

- Most banks have implemented employee recognition schemes in promoting positive behaviours, such as through monetary and non-monetary rewards for staff who demonstrate exemplary behaviours. Some banks use interesting peer-to-peer recognition schemes through which the staff can nominate, be nominated by, recognise and reward each other.

Figure 3 Use of rewards to promote positive behaviours



Banking Stability

Assessment and feedback mechanisms

- 90% of banks have set up their culture dashboard. Many of the banks have also utilised other tools such as employee surveys to assess their culture.
- While all banks have certain "speak up" mechanisms in place, only some banks have incorporated measures to ensure confidentiality of their "speak up" mechanisms and to protect the staff who choose to speak up from retaliation.

The HKMA also identified seven common themes to which AIs are encouraged to pay more attention:

(i) Further work is needed to ensure that incentive systems are designed to promote sound culture and prevent incidents of misconduct;

(ii) Stronger links are required to connect banks' Hong Kong operations with the culture efforts of their headquarters or upstream entities as well as their downstream operations;

(iii) Deeper analysis is expected to benchmark themselves against the findings from the reviews of the major overseas misconduct incidents;

(iv) More focus is needed to facilitate the continuous professional development of staff;

(v) More effort is needed to tackle the key challenge of culture assessment to identify gaps between the current progress and the desired culture;

(vi) More work is needed in promoting an environment which provides "psychological safety" to encourage staff to speak up without fear of adverse consequences; and

(vii) Sustained effort is required in driving cultural changes and banks should be mindful of "culture fatigue".

Insights drawn from the self-assessments had informed the HKMA's future work on bank culture. Meanwhile, the HKMA conducted seven culture dialogues with AIs during the year to discuss the effectiveness of their culture enhancement efforts, and to provide supervisory feedback, including observations gathered through the HKMA's ongoing supervision. The HKMA will conduct a focused review of incentive systems of front offices in the business of distributing banking, investment and/or insurance products in retail banks.

Financial inclusion

The HKMA continues to promote financial inclusion and encourage banks to pay special attention to customers in need. Further to the issuance of the Practical Guideline on Barrier-free Banking Services by HKAB in March 2018, the HKMA worked closely with HKAB to further enhance the accessibility to banking services by persons with intellectual impairment. Having consulted the Equal Opportunities Commission, Commissioner for Rehabilitation and Hong Kong Council of Social Service, HKAB and the DTCA jointly published the Guideline on Banking Services for Persons with Intellectual Disabilities in December. Endorsed by the HKMA, the Guideline sets out the principles and good practices recommended for the industry in providing banking services to, and establishing communication channels with, customers in need. The HKMA also issued a circular in December setting out the supervisory expectations for AIs providing retail banking services to implement recommendations in the Guideline and to provide proper training to frontline staff to ensure they can understand, communicate with and provide appropriate services to address the needs of customers.

Meanwhile, the HKMA continued to monitor the industry's implementation of the Practical Guideline on Barrier-free Banking Services. The industry continued to make good progress during the year. For example, over 95% of bank branches were wheelchair accessible; 99% of bank branches had posted notices at the main entrance stating that guide dogs are welcome; 1,180 voice navigation automated teller machines (ATMs) and over 1,200 ATMs with suitable height for wheelchair users were in operation; and assistive listening systems were available at over 850 bank branches.

The HKMA also continued to encourage banks to enhance accessibility to banking services for residents in public housing estates (PHEs) and remote areas. During the year, the coverage of mobile bank branches further expanded, bringing the total number of PHEs in Hong Kong being served by mobile bank branches to 30.

More details of the progress made in enhancing accessibility to banking services can be found in the *Corporate Social Responsibility* chapter.

Banking Stability

Opening and Maintaining Bank Accounts

The HKMA works closely with the banking industry and the business community to tackle the issues associated with opening and maintaining bank accounts in Hong Kong. While banks in Hong Kong have generally strengthened their AML/CFT controls in line with international standards, the HKMA has issued guidance to remind banks of the needs of bona fide businesses for basic banking services and to adopt a risk-based approach to the customer due diligence (CDD) process in account opening and maintenance. Banks are also required, throughout the CDD process, to maintain proper communication with customers, to be transparent, reasonable and efficient, and to observe the principle of "treating customers fairly".

The HKMA also continues to encourage banks to launch the Simple Bank Account (SBA) service that provides basic banking services with less extensive CDD measures to eligible corporate customers. Altogether four banks are now offering SBA service. Since the launch of SBA service in early 2019, over 6,000 SBAs have been opened successfully.

The HKMA's dedicated email account and hotline are made available for the public as well as the local and overseas business communities to lodge related enquiries and provide feedback. All enquiries and feedback received are handled and followed up by the HKMA's dedicated Account Opening and Maintenance Team.

The HKMA monitors the situation of bank account opening. The average unsuccessful rate of account opening applications is less than 5%, representing a significant improvement from around 10% in early 2016. The HKMA aims to maintain a robust AML/CFT regime in Hong Kong which would not undermine access by legitimate businesses and ordinary residents to basic banking services.

Banking Stability

Deposit protection

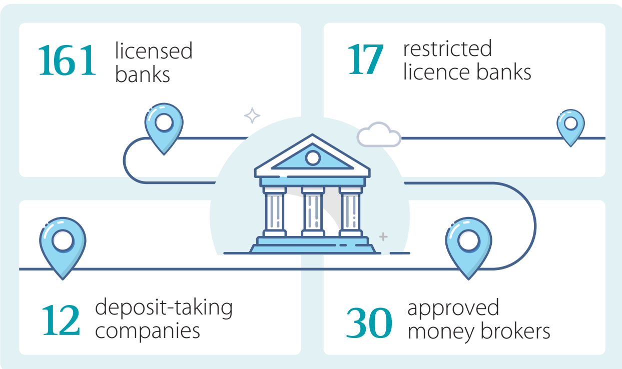
The DPS continued to provide protection to each depositor up to a limit of HK$500,000 per bank.

The Hong Kong Deposit Protection Board (HKDPB) has entered the final stage of implementing electronic payment channels, following completion of system development and a comprehensive drill test with the banking sector. The use of safe and faster electronic payment channels, including Faster Payment System (FPS), will supplement traditional paper cheque payments for DPS compensation.

A new advertising campaign themed "Bank Deposits Always Come with Protection" was launched in 2020 to bring out the key message of "DPS as the Guardian of Deposits". With the surge of online and social media consumption by the general public during the pandemic, "DPS Kung Fu Duo" and "DPS Saving Duo Comics" social media campaigns were also implemented along the same theme to reinforce public awareness and understanding of the DPS.

Licensing

At the end of 2020, Hong Kong had:



During the year, the HKMA granted banking licences to three non-local banks to operate a branch in Hong Kong. The authorizations of six licensed banks and one deposit-taking company were revoked during the year.

Enforcement

Banking complaints

The HKMA received 2,524 complaints against AIs and/or their staff members in 2020, representing an increase of 29% from 2019. Despite the rising trend, the HKMA completed the handling of 2,363 complaint cases, a 20% increase year-on-year, with 551 outstanding cases at the end of the year (Table 6). The HKMA handled each complaint in accordance with established procedures and followed up on issues of supervisory and disciplinary concern as identified during the handling process.

Table 6 Banking complaints received by the HKMA

	2020			2019
	Conduct-related issues	General banking services	Total	Total
In progress on 1 January	92	298	390	414
Received during the year	315	2,209	2,524	1,950
Completed during the year	225	2,138	2,363	1,974
In progress on 31 December	182	369	551	390

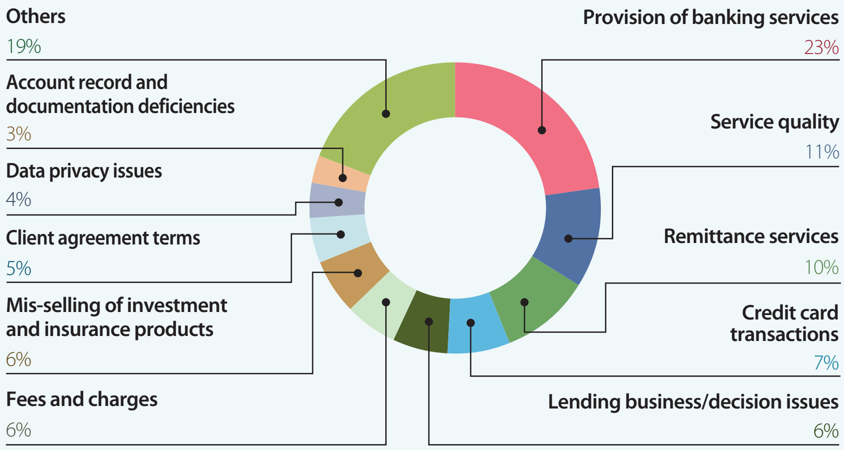
Issues concerning the provision of banking services continued to be the most common type of complaints, increased by 53% from 377 cases in 2019 to 576 cases in 2020. The majority of complaints in this category concerned the relevant AIs' practice in account opening and maintenance processes, such as delays in services and unclear communication with customers. In response to issues identified from complaints, the HKMA provided guidance to the AIs concerned to improve their customer interfacing capability.

Banking Stability

Complaints concerning fund transfers, card transactions and service quality rose by 38% from 510 cases in 2019 to 705 cases in 2020. These complaints included cross-border remittance service alleging fraud or investment scams, disputes over credit card transactions due mainly to undelivered services or goods, suspension or reduction in the scope and scale of banking services provided under the COVID-19 situation.

With the economic challenges presented by COVID-19, complaints about lending business/decision issues surged by 168% from a year ago to 158 cases in 2020. They included allegations of credit facility termination or denial of credit applications by companies and individuals. In addition, the HKMA received 460 informant reports against AIs and/or their staff members in 2020, compared to 493 cases in 2019. 43% of these reports implicated bank accounts in suspected fraud and cybercrime, and the HKMA has reminded the AIs concerned to cooperate with and extend assistance to law enforcement agencies on any investigations of suspected offences in relation to the informer cases and handle customers' requests in a pragmatic manner.

Chart 4 Types of services or products concerned in banking complaints received by the HKMA



Enforcement

To achieve consistent enforcement outcomes and deliver coherent deterrent messages to the industry, the HKMA collaborates closely with other financial regulators to investigate or follow up on possible compliance and fitness and properness concerns arising from AIs' self-reports, banking complaints and supervisory examinations of wealth management business conducted by AIs.

During 2020, the HKMA referred 29 cases to the SFC and shared with it the results of the HKMA's investigations and assessments of these cases under the MoU. Following referral by the HKMA, disciplinary sanctions were imposed on two RIs and three former relevant individuals pursuant to the SFO. The two RIs concerned were publicly reprimanded and fined HK$7 million and HK$4.2 million over internal system and control failures in relation to the sale of collective investment schemes, and failure to segregate client securities from proprietary securities in custodian accounts respectively. In other cases, three former RelS were banned from re-entering the industry for different time periods due to their misconduct, including conviction of fraud case, false declaration of personal securities dealings and fabrication of client's instruction, one for life, one for 21 months, and another for eight months.

Regulatory cooperation between the HKMA and the IA continued to strengthen in 2020. The two authorities maintained regulatory dialogues on matters of mutual interests. Based on the established collaborative arrangements under the MoU, the HKMA completed the handling of 106 cases and shared the results with the IA. Meanwhile, the IA referred 25 insurance-related cases concerning AIs to the HKMA for appropriate actions.

In close communication with the PCPD, the HKMA reminded AIs to stay alert to and manage the business risks in relation to theft of customers' personal information in unauthorised credit applications, and to assist affected bank customers and handle their requests in a reasonable and pragmatic manner.

During the year, the HKMA issued 30 compliance advice letters to AIs, as well as their staff members who were found to have not acted in full compliance with the relevant regulatory requirements, to address areas of concern identified and remind the AIs concerned about the importance of upholding standards of conduct and compliance.

Complaints Watch

As a continuing initiative to promote proper standards of conduct and prudent business practices among AIs, two issues of Complaints Watch were published in 2020. The newsletters have drawn AIs' attention to good practices in handling customer enquiries on long-established/closed accounts and treatment of joint bank accounts in the case where an account holder is diagnosed with mental incapacity. The HKMA also reminded AIs and their staff about effectively preventing and detecting conflicts of interest and market malpractices, in areas such as fabrication of client signature and staff concealment of personal securities accounts and transactions.

Electronic complaint form

The electronic complaint form was launched on 21 March to provide an additional digital channel for lodging complaints on banking products and services by members of the public. A total of 1,423 complaints were received through this channel, accounting for 56% of the total cases received in 2020.

Banking Stability

Capacity building in the banking sector

With fintech and green banking profoundly reshaping the banking sector, it is crucial for banks to develop, retain and attract talent to leverage the business opportunities and respond to challenges during the transformation. The HKMA has been working closely with the industry and other stakeholders to upskill existing practitioners, and train up the younger generation to enlarge the talent pool.

Creating talent pipeline for the banking sector

Capacity Building for Future Banking

To prepare for future talent demand, the HKMA, HKAB and the Hong Kong Institute of Bankers (HKIB) jointly undertook an industry-wide "Capacity Building for Future Banking" exercise to assess potential talent gaps in the banking sector in the next five years. The findings, released in June, revealed talent gaps in areas including technological and data skills, new banking business knowledge, and specific soft skills. This exercise helped provide a roadmap for banks to enhance the skill sets of their staff and expand the talent pool of the industry to meet the needs for future banking.

Banking Talent Programme

In view of the challenging job market conditions induced by the pandemic, the HKMA and the banking sector jointly launched the Banking Talent Programme in June. The programme was designed to provide fresh university graduates with short-term work opportunities in the financial industry and industry-related professional training. A series of seminars on various financial topics was arranged for the graduates, in addition to professional training courses and examinations. The programme also helped ensure that the supply of banking talent would not be disrupted by the pandemic. A total of 370 fresh graduates from local universities were offered job opportunities under the programme.

Financial Industry Recruitment Scheme for Tomorrow

The HKMA also supported the Financial Industry Recruitment Scheme for Tomorrow commissioned by the Financial Services and the Treasury Bureau and administrated by the Financial Services Development Council. In September, a circular was issued to the banking sector and stored value facility operators, encouraging them to provide job opportunities under the scheme to those who have an aspiration to develop a banking career.

Pilot Apprenticeship Programme for Private Wealth Management

2020 also saw the graduation of the third batch of apprentices under an apprenticeship programme for private wealth management. The programme was a joint initiative of the HKMA and the Private Wealth Management Association to develop future talent for the private banking industry. In light of the overwhelming response from students and participating private wealth management firms since the inception of the programme, another round of recruitment was conducted in November.

Upskilling banking practitioners

During the year, the HKMA continued to work closely with the banking industry and relevant professional bodies to develop new modules under the Enhanced Competency Framework (ECF) to facilitate talent development and enhancement of the professional competencies of banking practitioners. An ECF module on operational risk management which had taken into account feedback from the industry consultation was launched in December. The HKMA is making good progress in developing new ECF modules on compliance and fintech.

Since the ECF modules were first rolled out in 2016, about 13,000 banking practitioners had obtained recognised certifications by the end of 2020 to meet ECF benchmarks in various professional areas. This raises the overall level of professional competence in the banking industry in order to meet the growing demand for qualified banking practitioners.

Enhanced Competency Framework

2016	☑ Anti-Money Laundering and Counter-Financing of Terrorism (core level) ☑ Cybersecurity
2017	☑ Treasury Management ☑ Retail Wealth Management
2018	☑ Anti-Money Laundering and Counter-Financing of Terrorism (professional level)
2019	☑ Credit Risk Management
2020	☑ Operational Risk Management
Upcoming	☐ Fintech ☐ Compliance

To accommodate potential operational difficulties caused by the COVID-19 outbreak, the HKMA provided banking practitioners with flexibility in fulfilling their continued professional development requirements. Banking practitioners were also given an alternative option to classroom training through FLEX Learning, an online training platform launched by the HKIB in response to the pandemic.

Oversight of financial market infrastructures

The policy objectives of the HKMA in overseeing FMIs are to promote their general safety and efficiency, limit systemic risk, and foster transparency. The HKMA aims to make 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 approach taken by the HKMA in overseeing the FMIs under its purview is set out in a policy statement published on the HKMA website.

The Payment Systems and Stored Value Facilities Ordinance (PSSVFO) empowers the Monetary Authority to designate and oversee clearing and settlement systems that are material to the monetary and financial stability of Hong Kong, and to the functioning of Hong Kong as an international financial centre. The purposes of the PSSVFO include promoting the general safety and efficiency of the designated clearing and settlement systems: the Central Moneymarkets Unit, the Hong Kong dollar Clearing House Automated Transfer System (CHATS) (including the Hong Kong dollar FPS), the US dollar CHATS, the euro CHATS, the renminbi CHATS (including the renminbi FPS), and the Continuous Linked Settlement (CLS) System. The PSSVFO also provides statutory backing to the finality of settlement for transactions made through the designated clearing and settlement systems by protecting the settlement finality from insolvency laws and any other laws.

The HKMA is also responsible for overseeing the OTC Derivatives Trade Repository ("HKTR"). While the HKTR is not a clearing or settlement system and is thus not designated as such under the PSSVFO, the Monetary Authority will ensure that the HKTR is operated in a safe and efficient manner, which is in line with one of the functions of the Monetary Authority to maintain the stability and integrity of the monetary and financial systems of Hong Kong. All the designated clearing and settlement systems and the HKTR are treated as FMIs in Hong Kong.

The HKMA oversees local FMIs under its purview through off-site reviews, continuous monitoring, on-site examinations, and meetings with FMIs' management. In doing so, the HKMA adopts international standards in its oversight framework. The Committee on Payments and Market Infrastructures (CPMI) of the Bank for International Settlements and the IOSCO Technical Committee published the Principles for Financial Market Infrastructures (PFMI). The PFMI constitutes the latest international standards for the oversight of FMIs, including systemically important payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories. The requirements under the PFMI are incorporated in the relevant guidelines on designated clearing and settlement systems and trade repositories issued by the HKMA.

The HKMA has completed the PFMI assessments on the FMIs under its oversight. All the FMIs have published Disclosure Frameworks, which is a key requirement under the PFMI to improve transparency by disclosing system arrangements principle by principle. The PFMI assessment results and Disclosure Frameworks are available on the HKMA website.

In light of the outbreak of COVID-19, the HKMA has been closely monitoring the operations of the FMIs under its oversight and the sufficiency and appropriateness of the contingency arrangements implemented by the FMIs. Throughout the year, the HKMA participated in virtual CPMI meetings which, among other things, discussed issues related to the oversight of clearing and settlement systems amid COVID-19, as well as on enhancing cross-border payments. The HKMA also continued to work with FMIs to strengthen their endpoint security in accordance with CPMI guidance.

Banking Stability

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.

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, which commonly use SWIFT's services, may be exposed to risks in the event of any disruption to SWIFT's operations. During the year, the HKMA attended virtual meetings and teleconferences to discuss matters of interest, in particular the customer security framework developed by SWIFT and cybersecurity issues.

The HKMA participates in the international cooperative 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 to handle cross-border foreign exchange transactions. It enables foreign exchange transactions involving CLS-eligible currencies, including the Hong Kong dollar, to be settled on a payment-versus-payment basis. During the year, the HKMA attended various virtual meetings of the CLS Oversight Committee to discuss operational, developmental, and oversight matters.

The HKMA has established cooperative oversight arrangements with the relevant authorities, both at the domestic and international levels, to foster efficient and effective communication and consultation, in order to support one another in fulfilling their respective mandates with respect to FMIs.

Independent tribunal and committee

An independent Payment Systems and Stored Value Facilities Appeals Tribunal hears appeals against decisions of the Monetary Authority on licensing and designation matters under the PSSVFO. 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 PSSVFO 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 clearing and settlement systems. The Committee held two meetings and reviewed four regular reports and 36 accompanying oversight activities management reports in 2020. The Committee concluded that it was not aware of any case where the HKMA had not duly followed 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, and the report is available on the HKMA website.

PLANS FOR 2021 AND BEYOND

Supervisory focus

Supervision of credit risk

In 2021, the HKMA will undertake thematic reviews and examinations focusing on AIs' credit risk management practices, including assessing their connected lending practices and loan classification system. In addition, as SMEs are generally more vulnerable to the uncertainties stemming from the global and domestic environment, the HKMA will collaborate with the banking industry to support SMEs' financing needs to the extent consistent with prudent risk management principles.

Supervision of operational and technology risk

The HKMA will strengthen the capability of the banking sector to address existing and emerging operational and technology risks amid the trend of accelerated digitalisation. In light of the COVID-19 experience, additional resources will be devoted to assessing the operational resilience of AIs, including their capability to respond to extreme scenarios and escalating cyber risk. The HKMA has set out its supervisory expectations with regard to the implementation of C-RAF 2.0 and will monitor AIs' progress in this respect.

Adoption of supervisory technology

Leveraging on the rapid development of financial technologies in both the local and global financial markets, and the increasing availability of data, the HKMA will explore the adoption of Suptech solutions to enhance the effectiveness and forward-looking capability of its supervisory processes. Following a three-year roadmap developed earlier, a series of proof-of-concept exercises will be undertaken to evaluate the suitability of the technologies concerned before proceeding to production. The technologies under consideration include, but are not limited to, knowledge management systems, tools that serve to digitalise and automate workflows (such as speech-to-text and robotic process automation), as well as advanced analytics techniques, which include the use of natural language processing and machine-learning algorithms.

Supervision of liquidity and market risk

The HKMA will focus on the supervision of AIs' liquidity and market risk management in 2021. Apart from conducting on-site examinations and thematic reviews of AIs' risk management systems, the HKMA will monitor AIs' readiness to the transition from LIBOR to ARRs.

Combating money laundering and terrorist financing

In 2021, the HKMA's AML/CFT work will continue to focus on the industry's response to COVID-19, as well as offering guidance and engagement in response to increased geopolitical risks. The HKMA will continue to work closely with the Government, AIs and the SVF sector to finalise the next Hong Kong ML/TF Risk Assessment and to amend the Anti-Money Laundering and Counter-Terrorist Financing Ordinance to align with the latest international standards. The amendments seek to introduce increased risk-based flexibility, such as facilitating wider adoption of remote on-boarding.

The HKMA will continue to benchmark the banking and SVF sectors' response to ML/TF risks against international expectations, following recognition of the HKMA's AML/CFT supervision by the FATF Mutual Evaluation in 2019, while seeking to increase cooperation with other parts of Hong Kong's AML/CFT eco-system in mitigating these risks. We will support the work of FMLIT through efforts to promote information sharing, and continue to actively participate in global standard setting and policy deliberation.

Banking Stability

The HKMA will continue to promote AIs' adoption of Regtech following the 2019 AML/CFT RegTech Forum and publication of the report *AML/CFT Regtech: Case Studies and Insights* in January 2021. We will provide guidance and clarification on regulatory expectations, facilitate innovation in areas such as transaction monitoring and screening, and enhance the industry's collective ability to reduce the risk of money laundering networks through data analytics, information sharing and collaboration.

The HKMA's project to digitally transform its AML/CFT supervision will continue with a focus on upskilling, particularly in monitoring and analytics capabilities to deepen understanding of new and emerging ML/TF risks and facilitate agile responses.

Smart banking

As part of the Banking Made Easy initiative, the HKMA will continue to promote the adoption of Regtech and foster a larger and more diverse Regtech ecosystem in Hong Kong. The HKMA will implement a two-year roadmap published in November 2020 to accelerate Regtech adoption in the banking sector. A series of events and activities will be rolled out, including:

- hosting a large-scale event to raise the banking sector's awareness of the potential of Regtech;
- launching a Regtech Adoption Index;
- organising a Global Regtech Challenge to stimulate innovation;
- publishing a "Regtech Adoption Practice Guides" series;
- creating a centralised "Regtech Knowledge Hub" to encourage information sharing; and
- establishing a Regtech skills framework to develop talent.

Supervision of wealth management and MPF-related businesses

In 2021, the HKMA will carry out on-site examinations and off-site surveillance of AIs' conduct in the sale of securities, MPF and other investment and insurance products, with focus on the implementation of the WMC Scheme, high-risk investment products and non-investment-linked long-term insurance products.

In the supervisory process, the HKMA will communicate closely with other regulators and the banking industry to provide guidance on regulatory standards in relation to the sale of investment, insurance and MPF products, and issue further guidance regarding investor protection for the sale of investment and insurance products through non-F2F channels. The HKMA will also continue to collaborate with the SFC and the IA in conducting joint examinations on matters of mutual interest.

The HKMA will work with relevant authorities and the banking industry to finalise the implementation details and supervisory framework for the launch of the WMC Scheme. Moreover, the HKMA will also finalise the Code of Practice for Trust Business and related supervisory framework for implementation.

Implementation of Basel Standards in Hong Kong

Capital standards

The HKMA is working towards submitting to the Legislative Council for negative vetting during the second half of 2021 a set of amendments to the Banking (Capital) Rules for implementing the EIF standard, targeting to be effected by the end of 2021 or early 2022.

The HKMA will proceed with the preparatory work for implementing the Basel III final reform package and the revised market risk standards, having regard to industry feedback, as well as the implementation timelines adopted by other major financial centres.

Exposure limits

The HKMA intends to propose amendments to the Banking (Exposure Limits) Rules to better clarify policy intent, implement recommendations from international peer review and incorporate changes consequential to amendment of related capital rules.

Disclosure standards

The Basel Committee released the "Pillar 3 Disclosure Requirements — Updated Framework" in 2018 to incorporate revisions to the Pillar 3 framework, mainly to reflect disclosure requirements associated with the revised capital standards set out in the Basel III final reform package. These requirements constitute the third and final phase of the revised Pillar 3 disclosure requirements, and are currently scheduled to be implemented concurrently with the Basel III final reform package (i.e. 1 January 2023). The HKMA will consult the industry on its proposed approach to implementing these requirements.

Banking Stability

Other supervisory policies and risk management guidelines

To reflect developments in related regulatory requirements and international standards, the HKMA plans to update certain SPM modules, including those on "Stress-testing", "Foreign Exchange Risk Management", "Countercyclical Capital Buffer — Approach to Its Implementation", "Interest Rate Risk in the Banking Book" and "Code of Conduct". The HKMA will continue to work on the revised SPM modules on "Guideline on a Sound Remuneration System" and "Reporting Requirements Relating to Authorized Institutions' External Auditors under the Banking Ordinance", aiming to finalise the revisions within 2021.

Balanced and responsive supervision

Amid the fast-changing banking environment and risk landscape, the HKMA will continue to communicate closely with the banking sector to explore the scope of further refining and streamlining supervisory policies and practices with a view to promoting sustainable development of the banking sector without compromising supervisory effectiveness.

Accounting standards

Further to the first-phase amendments issued in September 2019 to provide relief from potential effects of the uncertainties caused by the interest rate benchmark reform, the International Accounting Standards Board published the second-phase amendments in August 2020 to address the financial reporting issues that may arise when an existing interest rate benchmark is replaced with an ARR. The HKMA will continue to monitor the financial reporting impact of interest rate benchmark reform and the implementation of International Financial Reporting Standard 9 by AIs in Hong Kong. The HKMA will maintain regular dialogue with AIs' external auditors and assess the implications of other impending accounting standards for the existing prudential requirements on AIs.

Green and sustainable banking

The HKMA will step up its effort in promoting green and sustainable banking. The HKMA is planning to consult the industry on the supervisory requirements for climate change risk management in the first half of 2021. This will include mandating climate-related disclosures that are aligned with the Task Force on Climate-related Financial Disclosures recommendations no later than 2025. With a view to enhancing climate risk resilience of the banking sector, the HKMA will launch the pilot CRST in 2021 and engage the participating AIs throughout the process to ensure they are progressing in the right direction. The HKMA will seek to play a leading role internationally via active participation in various international and regional forums to share experiences and coordinate efforts on the international front to tackle climate change-related risks.

Resolution

The HKMA will continue its multi-year programme to build an operational resolution regime for AIs. For 2021, the HKMA will prioritise the following topics within its three core objectives (see Table 7 for details).

Table 7 HKMA's forward priorities on resolution in 2021

Resolution Standards	Resolution Planning	International Policy, Regional Cooperation and Execution Capability
♦ Finalise rules on contractual stays and consult on related CoP chapter ♦ Consult on and finalise a CoP chapter on OCIR ♦ Consult on a CoP chapter on AIs' liquidity reporting and estimation capabilities ♦ Develop a CoP chapter on continuity of access to FMIs	♦ Advance bilateral resolution planning programmes with D-SIBs, assessing resolvability and working with banks to address impediments to an orderly resolution ♦ Continue implementation of LAC requirements for D-SIBs and start implementing OCIR standards and rules on contractual stays ♦ Commence development of preferred resolution strategies for locally incorporated AIs other than D-SIBs, with total consolidated assets above HK$300 billion ♦ Coordinate with relevant authorities via CMGs and Resolution Colleges on cross-border resolution planning for G-SIBs and crisis preparedness	♦ Continue to contribute to international policy developments and implementation monitoring ♦ Chair and provide secretariat function for the EMEAP's resolution forum, the SGR ♦ Advance the development of local mechanics to execute bail-in and transfer stabilization options ♦ Advance the development of an inter-agency crisis management framework with other Hong Kong authorities

Banking Stability

Bank consumer protection

The HKMA will participate in, and provide advice to, the Code of Banking Practice Committee of HKAB in 2021 to review the Code in the light of the growing digitalisation of financial services. The HKMA will also continue to monitor AIs' compliance with the Code through various means, including via AIs' self-assessment and handling of relevant complaints against them.

With the aim of promoting a sound bank culture, the HKMA will conduct a focused review in 2021 to identify industry-wide insights and practices for sharing with the banking industry and will continue to have culture dialogues with AIs. The HKMA will also explore other culture initiatives taking into account overseas experience and emerging themes that may arise while maintaining dialogue with overseas regulators on the development of bank culture.

The HKMA is working closely with the industry associations to introduce more than one consumer CRA in Hong Kong to enhance the service quality of consumer CRAs and address the risk of single point of failure of having only one CRA. The industry associations aim to select the CRAs through a tender process. The selected CRAs will then undergo system development and testing, and the new multiple CRAs model is expected to be in operation by the end of 2022.

The HKMA is developing the implementation details of the Mandatory Reference Checking Scheme with the industry to address the "Rolling Bad Apples" phenomenon in the local banking sector, taking into account the responses received from the consultation, to pave the way for the subsequent industry-led effort to implement the Scheme.

Financial inclusion

The HKMA will carry on its engagement with the banking industry, business community and relevant stakeholders to further enhance financial inclusion in Hong Kong, taking into account market developments and opportunities in the digital age.

The HKMA will also monitor the industry's implementation of measures recommended in the Practical Guideline on Barrier-free Banking Services and the Guideline on Banking Services for Persons with Intellectual Disabilities.

Deposit protection

The HKDPB will conduct a review of the DPS in 2021-2022 primarily to assess the adequacy of the DPS Fund and the scope of deposit insurance coverage in Hong Kong. Such a review is conducted periodically to ensure that the public policy objectives of the DPS are met. To maintain its readiness to payout, HKDPB will conduct a payout rehearsal with a focus on using electronic payment channels, which will be made ready in 2021, to compensate depositors. Annual self-assessments and on-site examinations will continue to be conducted to ensure that DPS member banks make appropriate representations to depositors in respect of the protection status of deposits. In addition, the HKDPB will roll out multimedia publicity and social media campaigns that resonate the affinity of money-saving to promote the DPS in light of its 15th anniversary.

Enforcement

The HKMA will continue to assess or investigate cases coming to its attention on possible breaches of requirements under the various statutory regimes relevant to AIs and stored value facility licensees in order to achieve the objectives of market integrity and bank customer protection. The full range of supervisory and enforcement measures will be considered and deployed as appropriate. The HKMA will maintain close collaboration with other local financial regulators to achieve effective and coordinated enforcement outcomes. It will also maintain close communication with the banking industry and share with them the latest complaint trends and good practices in order to promote proper standards of conduct and prudent business practices among AIs.

Capacity building in the banking sector

Creating talent pipeline for the banking sector

The "Capacity Building for Future Banking" exercise has demonstrated the commitment of the HKMA and the banking sector to addressing future talent needs. The HKMA will embark on a more holistic talent development strategy in order to promote talent development in a more structured and coordinated manner. In particular, the HKMA will reach out to relevant stakeholders, including universities, to enhance their awareness of the knowledge and skills required by the banking sector, which will help increase the supply of quality talent for the banking sector in the future.

Upskilling banking practitioners

The HKMA will maintain close collaboration with the banking industry and relevant professional bodies to develop new ECF modules that match industry needs and will review the effectiveness of the ECF modules in promoting professional development of banking practitioners. The HKMA will also continue its efforts in empowering the existing banking practitioners through the provision of training in collaboration with industry bodies and other stakeholders.

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 PFMI and the various guidance issued by the CPMI. It will also fine-tune the FMI oversight framework taking into account the latest developments including the COVID-19 situation.

The HKMA will work with the FMIs on their observance of the PFMI. Assessments will be conducted and updated as required, and the HKMA will continue to participate in the CPMI-IOSCO PFMI implementation monitoring and assessment exercise. The HKMA will also participate in the work of international standard setting bodies and will strengthen its oversight requirements to reflect international practices or in response to market and technology developments. In particular, the HKMA will focus on the operational and cyber resilience of the FMIs under its purview. Furthermore, the HKMA will work with relevant authorities to further strengthen cooperative oversight arrangements where appropriate.