



Hong Kong Regulatory Overview and Update – Second half of 2014

Summary

- Overview of Hong Kong regulatory structure
- Describes the latest Finance regulatory updates for banks and capital market companies in 2014
- Analysis the key regulatory changes of HK Trade Repository, Banking Returns of International Banking Statistics and Renminbi (RMB) Statistics

Following on from the liberalization of cross-border movements of capital, Hong Kong continues to evolve its regulations with regards to the banking and securities commission: specifically to remain aligned to international standards. This update from the SIA Partners Financial Services team describes the regulatory environment in Hong Kong and summarizes the forthcoming regulatory changes with analysis of the key changes.

Hong Kong Regulatory Environment Overview

The supervision of financial markets in Hong Kong is mainly categorized into 3 sectors: Banking, Securities & Futures and Insurance.

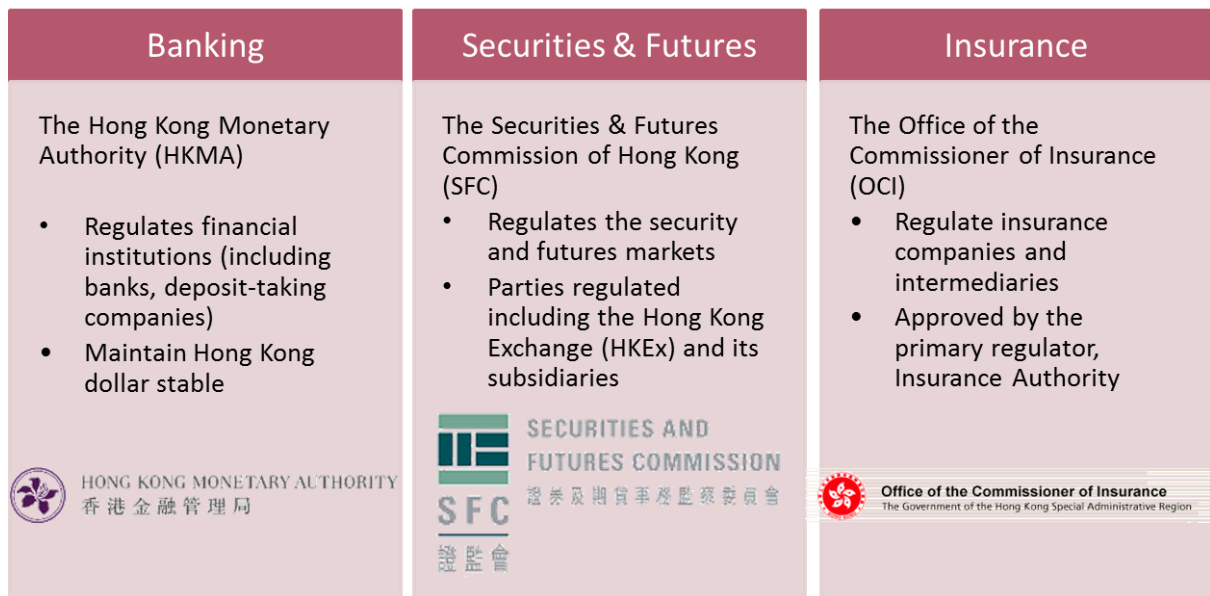


Figure 1. Regulatory framework in Hong Kong financial markets

Apart from these major regulatory parties, there are a couple of other entities that contribute to the stability of financial markets in Hong Kong. For example, the Hong Kong Deposit Protection Board (HKDPB) and Hong Kong Association of Banks (HKAB) for banking activities; the Hong Kong Exchanges and Clearing (HKEx) for securities; and Hong Kong Federation of Insurers (HKFI) for Insurance activities.

Banking sector - The Hong Kong Monetary Authority (HKMA)



HONG KONG MONETARY AUTHORITY
香港金融管理局

The Hong Kong Monetary Authority (HKMA) is the government authority responsible for

maintaining monetary and banking stability in Hong Kong. They also promote the safety and integrity of the financial and banking system, maintain and develop Hong Kong's financial infrastructure as well as managing the Exchange Fund.

For monetary stability, HKMA maintains the stability of Hong Kong dollar exchange rate under the framework of the Linked Exchange Rate system (HKD is pegged with USD at 1 USD = 7.8 HKD) through an automatic interest rate adjustment mechanism

For Banking Stability, HKMA regulates and maintain the three-tier banking system: (1) Licensed Banks – Accept deposit with any



maturity and size, and pay or collect cheques (2)
 Restricted License Banks – Accept deposit with any maturity and amounts \geq HK \$500,000 (3)
 Deposit Taking Companies – Accept deposit with maturity \geq 3 months and amounts \geq HK \$100,000. To improve confidence for individual investors on the Hong Kong's banking system, Deposit Protection Scheme Ordinance provides protection up to HK \$500,000 per depositor per bank.

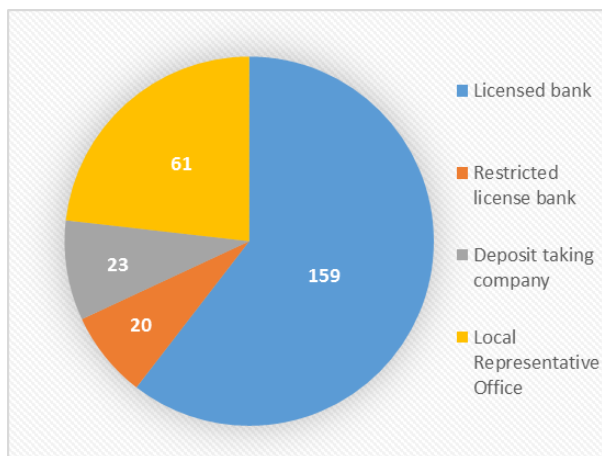


Figure 2. Authorized Institution composition in Hong Kong¹

transaction conducted on the Hong Kong Stock Exchange (HKEx) and the Hong Kong Futures Exchange (HKFE), and fees charged to license applications. SFC supervises market operators including exchanges, clearing house and alternative trading platforms, issue license and supervises intermediaries and authorizing investment products.

Insurance sector - The Office of the Commissioner of Insurance (OCI)



The Office of the Commissioner of Insurance (OCI) is the government authority responsible for supervision of insurers carrying on general insurance business. Their mission is to protect the interests of policyholders and to promote stability of the insurance industry. OCI liaises with industry and professional bodies on regulatory development and publishes statistics on the Hong Kong general insurance market.

Securities & Futures sector - The Securities & Futures Commission of Hong Kong (SFC)



The Securities & Futures Commission of Hong Kong (SFC) is an independent statutory body to regulate the securities and futures markets in accordance to the Securities and Futures Ordinance (SFO). SFC is funded by levies on

¹ Source: HKMA, updated as of May 16, 2014



Regulatory reports required in Hong Kong

Under the regulatory framework in Hong Kong, major regulatory reports that require cover are:

1. Financial returns for HKMA
2. Trade and Position reports (for SFC and HKEx)

Financial Returns

HKMA sets the standard of financial disclosure in Hong Kong and ensures standards are in line with other leading financial centers. The disclosure standards reflect the financial health of different requirements for Authorized Institutions (“AI”), more detail requirements applies to Locally Incorporated Authorized Institutions than to Overseas Incorporated Authorized Institutions.

Frequency	Return	Name of Financial Returns
Monthly	MA(BS)1, 1A, 1B	Assets and Liabilities
Quarterly	MA(BS)1C	Profit and Loss Account
Quarterly	MA(BS)1D	Large Exposures
Monthly	MA(BS)1E	Liquidity Position
Quarterly	MA(BS)1F (a), (b)	Certificate of Compliance
Quarterly	MA(BS)1G	Maturity Profile
Monthly	MA(BS)2	External Liabilities and Claims
Quarterly	MA(BS)2A	Loans and Advances and Provisions
Quarterly	MA(BS)3	Capital Adequacy Ratio
Monthly	MA(BS)6	Foreign Currency Position
Quarterly	MA(BS)9	Cross-Border Claims
Monthly	MA(BS)11	Hong Kong Dollars Interbank Transactions
Quarterly	MA(BS)12	Interest Rate Risk Exposures
Quarterly	MA(BS)12(i)	Interest Rate Risk Exposures (Supplementary Information)
Half yearly	MA(BS)13	Mandatory Provident Fund Related Activities
Half yearly	MA(BS)14	Securities Related Activities
Half yearly	MA(BS)15	Insurance Related Activities
Monthly	MA(BS)16	Return of Renminbi (RMB) Business Activities
Quarterly	MA(BS)18	Return on Selected Data for Liquidity Stress-testing
Quarterly	MA(BS)20	Return of Mainland Activities

Source: HKMA, updated as of June 4, 2014



Trade and Position Reporting

SFC enforces market regulation including investigation on market misconduct and defines the Securities and Futures Ordinance. The Ordinance empowers them to collect regulatory reports to monitor the market.

Frequency	Return	Notes
On demand	S181 return	Required by Ordinance Chapter 571 Section 181
Weekly	Short position reporting	Required since 18 June 2012, submit through SFC Online Services Portal
On demand	Position Limits Reports, Large Open Position Reports	Required since 21 December 2007

Source: SFC, updated as of June 4, 2014

Regulatory Updates

This section describes the latest Finance regulatory updates for Banks and Capital Market firms in Hong Kong. In 2014, HKMA has announced changes over the liquidity, banking regulatory reports.

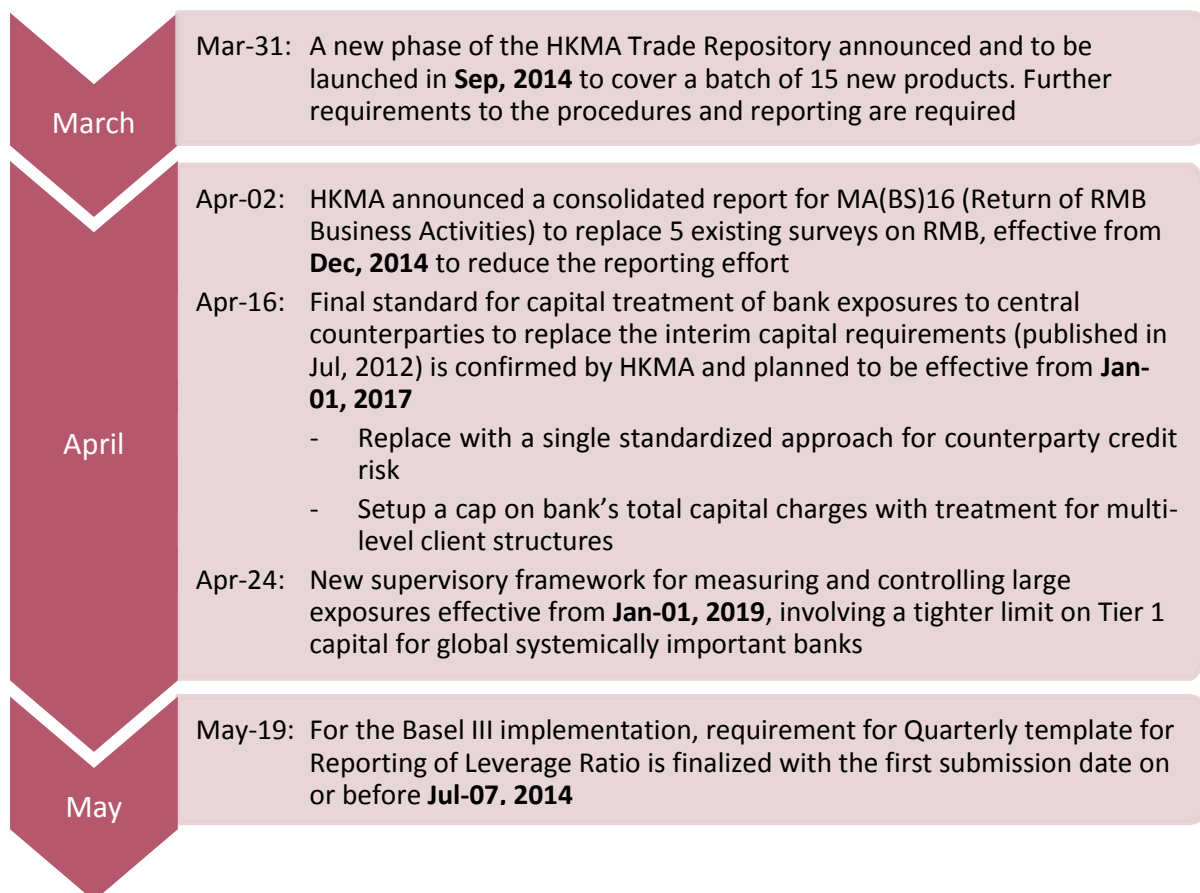


Figure 3. Recent update on regulatory changes by HKMA
Source: Author's compilation

Coming Up Rules Effective

In the Second half of 2014 and early 2015, there are 3 key changes enforced by HKMA and SFC for Banks and Investment firms in Hong Kong, (1) new phases for Hong Kong Trade Repository launched in September, (2) new Quarterly Return of International Banking Statistics MA(BS)21 and (3) Change in Return on RMB Statistics MA(BS)16 in December's financial return.

The diagram below has illustrated the key timeline for the changes mentioned.

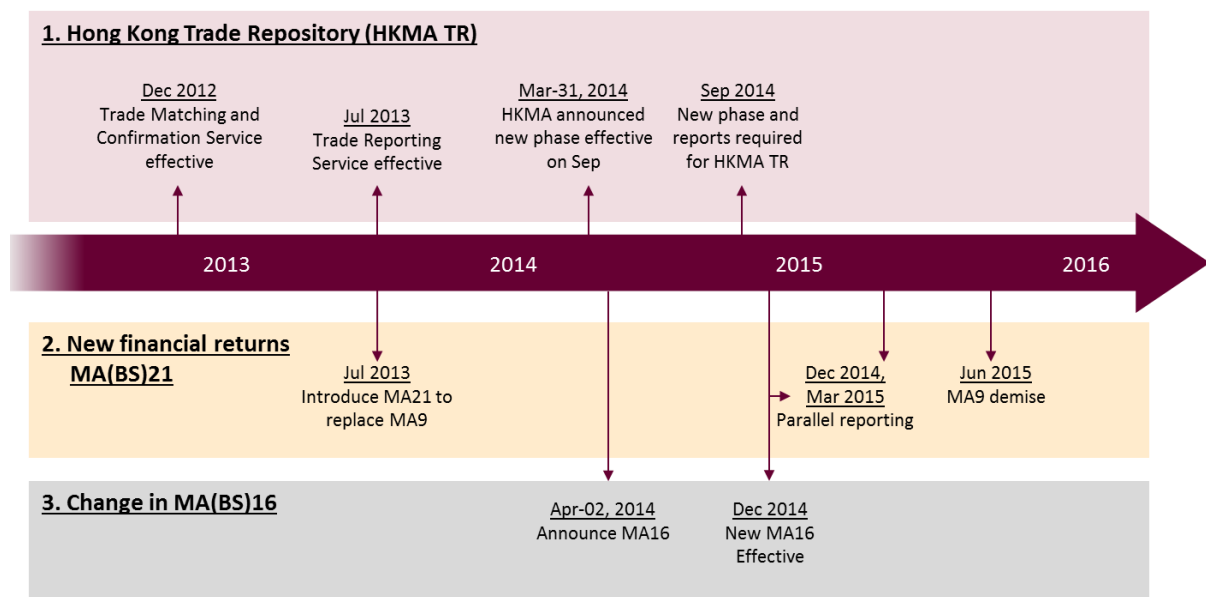


Figure 4. Future regulatory changes enforced by HKMA and SFC
Source: Author's compilation

Hong Kong Trade Repository (HKMA TR)

Post the financial crisis in 2008, G20 Leaders agreed at the 2009 summit in Pittsburgh that standardized OTC derivatives contracts should be cleared through central counterparties by the end of 2012. HKMA has further provided Trade matching and confirmation service for OTC derivatives transactions in Hong Kong on December 2012. It aligns market standards and improves monitoring with HKEx acting as a clearing party.

For regulatory monitoring, HKMA provided interim trade reporting services on July 2013 with the proposed regulatory framework in 2012². HKMA Trade Repository provides an electronic system for collecting, maintaining details of OTC derivatives transaction efficiently with objective to allow market participants to meet the statutory reporting requirements. In Sep 2014, this reporting service launched a new phase to support new products with improvement to the messages standards.

² HKTR (2014). *Official website for HKTR*. Available at: <https://hktr.hkma.gov.hk/>



Major changes in products are as follows:

Product Categories	Existing HKTR (Jul 2013)	New HKTR (Sep 2014)
Interest Rate Derivatives	Only Single Currency Interest Rate Swap (Floating vs Fixed, Basic Swap, Overnight Index Swap) is supported	Single Currency Interest Rate Swap (Added Fixed vs Fixed, Inflation Swap) The following products are added as well: Cross Currency Interest Rate Swap, CapFloor, FRA, Option
Foreign exchange derivatives	Non Deliverable Forward	Non Deliverable Forward, Forward, Non Deliverable Option, Vanilla Option
Equity derivatives	Not supported	Swap, Option

MA(BS)21 - Quarterly Return of International Banking Statistics

Bank for International Settlements (BIS) has taken the initiative to improve the international banking statistics (IBS) for the surveillance of global financial stability. It has released the newly revised requirements on the statistics³. HKMA adopted the enhanced reporting requirements as they are a BIS member.

Existing returns	New returns
MA(BS)9A – Part I: External Liabilities and Claims	MA(BS)21A – Part I: Locational Banking Statistics (LBS)
MS(BS)9B – Part II: Cross-border Claims	MA(BS)21B – Part II: Consolidated Banking Statistics (CBS)

During the parallel run, authorized institutions are expected to submit both MA(BS)21 and MA(BS)9 for December 2014 and March 2015 report submission⁴. On or after June 2015, authorized institutions will no longer be required to submit these. In summary, more granular information is required including further breakdown in currency, geographical location, sector and maturity and further information in domestic claims and liabilities and local claims in foreign and local currencies.

³ Bank for International Settlements (BIS) (2014). *Guidelines for reporting the BIS international banking statistics*. Available at: <https://www.bis.org/statistics/bankstatsguide.htm>

⁴ HKMA (2013). *Circular on Dec 31, 2013*. Available at: <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2013/20131231e1.pdf>



MA(BS)21A - Part I: Locational Banking Statistics

This return is designed to replace MA(BS)9A, collect AIs' liability and claim positions broken down by instrument, counterparty country, counterparty sector and currency. There are five key changes categorized as below:

Reporting attributes	Existing returns MA(BS)9A	New returns MA(BS)21A
Currency breakdown	3 Currencies (HKD, USD, Others)	8 Currencies
Geographical breakdown	111 countries, regions and organizations	226 countries, regions and organizations
Sector breakdown	2 Sectors (Bank or Non-bank customers)	4 Sectors (further breakdown Bank or Non-bank customers)
Maturity breakdown	Not required	Required for Liabilities in debt securities with remaining maturity up to and including 12 months
Liabilities to & Claims on domestic sector	Not required	New domestic sector is required (4. Hong Kong – HK)

MA(BS)21B - Part II: Consolidated Banking Statistics

This return collects AIs' exposures and liabilities to both local and foreign counterparties which also takes into account the ultimate risk lies for assessing country credit risk exposures.

One of the key new requirements is to report local claims on top of the cross-border claims in MA(BS)9B. This provides a better picture on their corresponding exposure. All local incorporated AIs are required to report their Hong Kong office position and consolidated position, i.e.

1. Cross-border claims
2. Local claims in foreign currencies
3. Local claims in local currencies (including branches in office outside Hong Kong on consolidated basis)

For Non-locally incorporated AIs, item 3 is out of scope (i.e. only Hong Kong office position is needed).

The new design aimed to provide a better illustration on the direct and ultimate counterparty risk and breakdown into 3 sub-sections:

- Part IIA: Consolidated banking statistics - immediate risk basis and risk transfers
- Part IIA: Consolidated banking statistics - supplementary data on funding sources
- Part IIB: Consolidated banking statistics - ultimate risk basis



Section 1: Part IIA. Consolidated banking statistics - immediate risk basis and risk transfers

Reporting attributes	Existing returns MA(BS)9B	New returns MA(BS)21B
Total claim	All external assets with risk transferred from one country to another (i.e. Cross-border claims)	All domestic and external assets with risk transferred, categorized into 2 new categories: (i) International claims (Cross-border claims + local claims in foreign currencies) (ii) Local claims in local currencies
Geographical breakdown	111 countries, regions and organizations	226 countries, regions and organizations
Sector breakdown	3 sectors for Cross-border claims (Banks / Public sector / Others)	4 sectors for Cross-border claims (Banks / Official sector / Non-bank private sector / Unallocated). No breakdown is required for Local claims (both local and foreign currencies)
Risk transfer	Reported with intermediate and ultimate risk basis breakdown by Bank / Public sector / Others	Reported by Inward and Outward risk transfer. New requirement in identifying ultimate obligor with "look-through" approach
Others	1. Country debt provisions, subordinated deposit and arrangement in lieu of provisioning is required. 2. Undistributed credit commitments & back-up facilities	1. Not required. 2. Not reported in Part II A, report in Part II B

Section 2: Part IIA. Consolidated banking statistics - supplementary data on funding sources

This is a new section that is required for a firm to report the consolidated positions according to products and capital categories with syncs to the Basel definition (e.g. Tier 1 capital). This section is for locally incorporated AIs on a consolidated basis only, which is out of scope for Non-locally incorporated AIs.



Section 3: Part IIB. Consolidated banking statistics - ultimate risk basis

This is a new section that is required for a firm to report claims allocated to the country where the final risk lies. Reporting of certain off-balance sheet exposures is required in this section. This section is for locally incorporated AIs on consolidated basis only, which is out of scope for Non-locally incorporated AIs.

The items reported are categorized as follow:

- Reporting items for claims are same as Part IIA (includes Total claims, Financial claims by sector), except Interoffice activities are excluded and Counterparty country are allocated according to ultimate obligor (e.g. report in office of guarantor instead of country of claim's counterparty)
- New requirement to disclose Derivatives contracts with a positive market value. For credit default swaps and total return swaps there is a special handling. If AIs are a protection-buyer, report in this section if they are held for trading, otherwise, report as "Risk transfer". If AIs are protection-seller, report gross notional values in "Guarantees extended" section
- New requirement to disclose extended Guarantees, which is the Contingent liabilities arising from an irrevocable obligation to pay a third-party beneficiary

MA(BS)16 - Simplified reporting of Renminbi (RMB) Statistics

Effective from Dec, 2014⁵, the objective of this regulatory change is to fulfil the latest development on RMB as well as reducing the reporting effort. Some of the highlights are illustrated below:

1. New requirements to add RMB currency futures under "derivatives products" for data completeness, Money exchange and remittances for non-Hong Kong residents and RMB liquidity position
2. Combing reporting items, for example, a new reporting item "Banks in Mainland China" will combine "Due to/from Mainland Correspondent Banks"
3. Dropping reporting items, for example, Removed previous Part H Memorandum items and Part I Certificate of Compliance
4. Decommission of 5 surveys, including RMB conversions for non-Hong Kong residents, etc.

⁵ HKMA (2014). *Circulars on April 2, 2014*. Available at: <http://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2014/20140402e1.pdf>



On a final note

Hong Kong has a robust and efficient regulatory framework to govern the operations of the financial institutions, securities and insurance companies. The enforcement of Global regulatory change such as the Dodd-Frank Act, EMIR, MiFIR and Basel III directly impacts on Hong Kong regulators to reform their requirements to align with International standards. The benefits of these new regulations enhance stability and confidence with better risk disclosure. This year with the coming up changes like Trade reporting is going to set another milestone of regulatory reform for all financial institutions in Hong Kong.

For further information on how Sia partners can assist your organization to address the changing regulatory, please contact: Sia Partners Hong Kong, +852 3975 5611, Vincent.Kasbi@sia-partners.com

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