

Hong Kong Financial Regulatory Newsletter

This publication provides highlights of the significant developments in regulations of the Hong Kong financial markets and analysis of new laws/regulations affecting the financial services sector in Hong Kong.



Key regulatory developments:

The Securities and Futures Commission (SFC)

- **16 Jan 2015** - SFC signs MoU with ESMA on cooperation arrangements for Hong Kong-established central counterparties
- **22 Jan 2015** - Circular to Licensed Corporations in relation to the Second-stage Public Consultation to Establish Effective Resolution Regime for Financial Institutions in Hong Kong
- **22 Jan 2015** - Circular to Licensed Corporations and Registered Institutions - Frequently Asked Questions on Corporate Professional Investor Assessment and Description of Services in Client Agreements
- **30 Jan 2015** - Amendments to Code on Unit Trusts and Mutual Funds take effect

The Hong Kong Monetary Authority (HKMA)

- **6 Jan 2015** – Circular on Selling of Investment Products
- **27 Jan 2015** - Monetary Authority Announces Countercyclical Capital Buffer for Hong Kong
- **2 Feb 2015** - Basel Committee Standards – Revised Pillar 3 disclosure requirements
- **4 Feb 2015** - Return of Liquidity Position of an Authorized Institution (Form MA(BS)1E)
- **6 Feb 2015** - Implementation of Basel III - Banking (Disclosure) Rules
- **6 Feb 2015** - Basel III Implementation – Standard Template for Disclosures in Relation to Liquidity Coverage Ratio (“LCR”)
- **6 Feb 2015** - The HKMA’s Approach to Applying Some Key Requirements in the Banking (Liquidity) Rules (“BLR”)
- **18 Feb 2015** - New Supervisory Policy Manual (SPM) Module CA-B-2: Systemically Important Banks
- **26 Feb 2015** - Refinement of the Renminbi Liquidity Facility
- **27 Feb 2015** - Supervisory Policy Manual (“SPM”) CA-G-1: “Overview of Capital Adequacy Regime for Locally Incorporated Authorized Institutions” (Revised)
- **12 March 2015** - Supervisory Policy Manual (“SPM”) CG-5: “Guideline on a Sound Remuneration System” (Revised)
- **31 March 2015** - Guidance Paper on Anti-Money Laundering Controls over Tax Evasion

Detailed Summary:

SFC

- **SFC signs MoU with ESMA on cooperation arrangements for Hong Kong-established central counterparties**

The Securities and Futures Commission (SFC) and the European Securities and Markets Authority (ESMA) have entered into a Memorandum of Understanding (MoU) on cooperation arrangements in connection with Hong Kong-established central counterparties (CCPs) which have applied for recognition by ESMA. The establishment of cooperation arrangements fulfils a precondition under European Market Infrastructure Regulation (EMIR) for ESMA to recognise these CCPs as eligible to provide services to clearing members or trading venues established in the European Union. The CCPs established in Hong Kong which have applied for recognition by ESMA are:

- Hong Kong Securities Clearing Company Limited;
- HKFE Clearing Corporation Limited;
- The SEHK Options Clearing House Limited; and
- OTC Clearing Hong Kong Limited.

[Click to read](#) the respective SFC news.

- **Circular to Licensed Corporations in relation to the Second-stage Public Consultation to Establish Effective Resolution Regime for Financial Institutions in Hong Kong**

The Hong Kong Monetary Authority (HKMA), the SFC and the Insurance Authority, on 21 January 2015, launched the second stage of public consultation for three months on establishing an effective resolution regime for financial institutions, including financial market infrastructures, in Hong Kong. The second stage of consultation seeks views on specific aspects of the regime including: further details on the resolution options and powers proposed in the first consultation paper; the governance arrangements and especially the approach to designating public authorities to act as resolution authorities; as well as safeguards including a 'no creditor worse off than in liquidation' compensation mechanism.

For licensed corporations (LCs), taking into account the feedback from the first consultation, it is now proposed that the following LCs should fall within the scope of the regime:

- (a) LCs which are themselves designated as non-bank non-insurer global systemically important financial institutions (NBNI G-SIFIs³);
- (b) LCs which are subsidiaries or branches of groups which are identified as being (or containing) G-SIFIs⁴.

As proposed in the first stage of public consultation, even if an LC is subject to the regime, it will still have to meet the following conditions before it can be resolved, which are:

- (1) the LC or the LC's G-SIFI Group is, or is expected to become, no longer viable; and
- (2) it is assessed that resolution will serve to contain risks posed by non-viability of the LC or the LC's G-SIFI Group to:
 - (a) the continuity of critical financial services; and
 - (b) the general stability and effective working of the financial system.

As work is still continuing at the international level to provide guidance on the implementation of certain aspects of the new standards, a third, shorter consultation is planned to be carried out in the first half of 2015. The Government invited written comments from members of the public and the industry to be submitted on or before 20 April 2015.

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- **Circular to Licensed Corporations and Registered Institutions - Frequently Asked Questions on Corporate Professional Investor Assessment and Description of Services in Client Agreements**

The SFC issued the Consultation Conclusions on the Proposed Amendments to the Professional Investor Regime and Further Consultation on the Client Agreement Requirements on 25 September 2014 (Consultation Conclusions). The changes made to the Professional Investor Regime, in the form of a new paragraph 15 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the Code), will come into effect on 25 March 2016. One of the key changes is the new assessment on Corporate Professional Investors (as defined in the new paragraph 15.2 of the Code) in relation to relevant products and/or markets before intermediaries can be exempted from certain Code requirements when dealing with Corporate Professional Investors in relation to such products and/or markets. Given that this assessment is principles-based, the SFC wishes to provide further guidance to intermediaries.

Separately, the SFC also wishes to provide guidance with regards to the application of paragraph 6.2(d) of the Code by elaborating on our expectations of the extent of description on types of actual services to be provided (please refer to paragraph 56 of the Consultation Conclusions).

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- **Amendments to Code on Unit Trusts and Mutual Funds take effect**

The SFC announced on the 30 of January 2015 that amendments to the Code on Unit Trusts and Mutual Funds were gazetted, thereby taking effect. The amendments were made to implement proposals to give public funds greater flexibility in determining the means for making public their offer and redemption prices, net asset values and notices of dealing suspension (Note 1). Updated frequently asked questions and circular are now available on the SFC website to provide further guidance to the industry on implementation of the proposals.

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HKMA

- **Circular on Selling of Investment Products**

The HKMA has reminded Authorized Institutions (AIs) about regulatory standards in relation to selling practices of structured deposits and investment products. AIs are reminded to exercise adequate management supervision and take positive steps to monitor their frontline staff to ensure that proper selling practices and controls are adopted. In addition, the HKMA stressed importance of the product due diligence, making adequate disclosure of product features and risks to customers in their selling process, so that customers understand the associated risks and costs before investing in the products. The regulator also urged AIs to follow requirements on marketing materials of investment products issued by the SFC. In particular, the HKMA highlighted that presentation of benefits and returns should come with, and not be more prominent than, the risks of the product. For example, the use of a different font size or text effect to make the potential returns or benefits of a product more prominent than the risk disclosure is not acceptable.

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- **Monetary Authority Announces Countercyclical Capital Buffer for Hong Kong**

The HKMA announced that the countercyclical capital buffer (CCyB) for Hong Kong will be 0.625% with effect from 1 January 2016.

In setting this CCyB rate the HKMA considered a series of quantitative indicators and qualitative information including an “indicative buffer guide” (which is a metric providing a guide for CCyB rates based on the gap between the ratio of credit to GDP and its long term trend, and between the ratio of residential property prices to rentals and its long term trend). The credit and property price gaps remain at elevated levels and a simple mapping from the indicative buffer guide (calibrated against the CCyB range of 0% to 2.5% in the Basel 3 regulatory capital framework) would signal a CCyB of 2.5% at the upper end of the Basel 3 range.

Whilst the indicative buffer guide, as its name suggests, provides a “guide” for CCyB decisions, the determination of a CCyB rate is not a mechanical exercise and, in addition to the indicative buffer guide, the HKMA also reviewed a range of other reference indicators. These included measures of: bank, corporate and household leverage; debt servicing capacity; profitability and funding conditions within the banking sector and macroeconomic imbalances. The information drawn from these sources was, in the view of the HKMA, consistent with the signal from the indicative buffer guide.

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- **Basel Committee Standards – Revised Pillar 3 disclosure requirements**

The Basel Committee on Banking Supervision (BCBS) issued its Revised Pillar 3 disclosure requirements¹ (revised requirements) on 28 January 2015. The revised requirements are the outcome of the first phase of the BCBS review of its existing Pillar 3 disclosure requirements in order to strengthen the regulatory disclosure framework, particularly in terms of the relevance and comparability of disclosed information to market participants. Specific focus is given to improving transparency in respect of the internal model-based approaches that banks use to calculate minimum regulatory capital requirements. The revised requirements feature a greater use of standard templates for quantitative disclosures, combined with flexibility for banks to provide commentary to reflect bank-specific circumstances and risk profiles. Scheduled to take effect from end-2016, the revised requirements cover regulatory risk weighted exposures for credit, market and counterparty credit risks and securitisation, and will supersede the corresponding existing Pillar 3 disclosure requirements (first issued as part of the Basel II framework in 2004 and subsequently updated by Basel 2.5 in 2009)

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- **Return of Liquidity Position of an Authorized Institution (Form MA(BS)1E)**

The HKMA informed AI that the Return of Liquidity Position can be now submitted to the HKMA via the STET system. The final version of this Return (and the accompanying Completion Instructions) is accessible on the HKMA’s public website (<http://www.hkma.gov.hk/eng/key->

functions/banking-stability/banking-policy-and-supervision/regulatory-framework.shtml). The electronic form of the Return is now available for AIs to download from the HKMA's supervisory communication website (<http://www.stet.iclnet.hk>). AIs should use the electronic form to report their liquidity positions to the HKMA, via the STET system, starting from the reporting period which ended on 31 January 2015.

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- **Implementation of Basel III - Banking (Disclosure) Rules**

Further to the HKMA letter of 24 December 2014, the period for negative vetting of the Banking (Disclosure) (Amendment) Rules 2014 ("BDAR 2014") by the Legislative Council has now expired. As a result, the amendments to the Banking (Disclosure) Rules brought about by the BDAR 2014 will come into operation on 31 March 2015. For category 2 institutions whose financial year does not end on 31 December, their first annual and/or interim reporting period in 2015 will straddle 2014 and 2015. In such cases, the category 2 institutions will be required by the Banking (Disclosure) Rules (as amended) to disclose the average value of their liquidity maintenance ratio ("LMR") for the reporting period concerned only in respect of those months in the period that fall on or after 1 January 2015, when the LMR came into effect. However, as the amended Rules no longer mandate disclosure of the liquidity ratio ("LR"), which was replaced by the LMR on 1 January 2015, those institutions will not be required to disclose the average value of their LR in respect of those months in the reporting period preceding 1 January 2015.

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- **Basel III Implementation – Standard Template for Disclosures in Relation to Liquidity Coverage Ratio ("LCR")**

The HKMA has issued the final version of the LCR standard disclosure template (including accompanying completion instructions). Pursuant to section 6(1)(ab) of the Banking (Disclosure) Rules, the template is to be used by category 1 institutions for the disclosure of their LCR (and related information) once the amendments to the Rules brought about by the Banking (Disclosure)(Amendment) Rules 2014 ("BDAR 2014") come into effect on 31 March 2015. The standard template is required to be used to meet the disclosure obligations in subsections (1), (3), (4) and (5) of sections 30A, 51A and 103A of the BDAR 2014, where applicable, for making interim and annual disclosures of institution's LCR (and related information), to the extent that the template covers the relevant required disclosure items, for the reporting periods ending after 31 December 2014.

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- **The HKMA's Approach to Applying Some Key Requirements in the Banking (Liquidity) Rules ("BLR")**

The HKMA issued an interim guidance regarding the approach that the HKMA will adopt in applying some key requirements set out in the BLR and related Code of Practice. The interim guidance will form the basis for the HKMA's forthcoming revision of the existing module "Liquidity Risk Management" (LM-1) under the Supervisory Policy Manual in the course of 2015, which may also include further guidance to take account of ongoing implementation experience. The revised LM-1 will be renamed "Regulatory Framework for Supervision of Liquidity Risk" to provide a comprehensive overview of the local regulatory liquidity framework (including guidance on the application of major requirements relating to the LCR and LMR). The HKMA has also taken opportunity to clarify several issues in the local LCR framework, as identified in a recent assessment of the consistency and completeness of Hong Kong's domestic regulations as against the Basel III LCR framework, which was conducted under the Basel Committee's Regulatory Consistency Assessment Programme ("RCAP").

The key aspects covered in the interim guidance relate to:

- Designation of authorized institutions as category 1 institutions and the related process;
- Supervisory monitoring of AIs' compliance with the minimum LCR requirement during the phase-in period (i.e. from 2015 to 2018);
- Notification of liquidity events to the HKMA and, where applicable, utilisation of HQLA in a period of financial stress;
- Recognition of HQLA (or liquefiable assets) under the LCR (or LMR) (including the approach to applying or interpreting certain eligibility criteria);
- Adoption of an "Alternative Liquidity Approach" in Hong Kong;
- Treatment of retail deposits (including the issue of assessing the significance of early withdrawal penalties for term deposits); and
- Treatment of operational deposits (including the approach to assessing whether the qualifying conditions are met).

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- **New Supervisory Policy Manual (SPM) Module CA-B-2: Systemically Important Banks**

The HKMA has published the above-mentioned SPM module as statutory guidance, by notice in the Gazette, under section 7(3) of the Banking Ordinance. Responding to lessons learned from the recent global financial crisis, the Basel Committee on Banking Supervision (Basel Committee) has established policy frameworks to address the risks posed by both global systemically important banks (G-SIBs) and domestic systemically important banks (D-SIBs). The rationale for adopting additional policy measures for systemically important banks is the significant “negative externalities” which these banks could create if they were ever to become non-viable. The work of the Basel Committee in this regard forms part of a broader effort by the Financial Stability Board to make these banks less susceptible to failure and thereby improve the resilience of the financial system and economy as a whole. The additional policy measures for G-SIBs and D-SIBs include the application of Higher Loss Absorbency (HLA) capital buffer requirements, together with more intensive supervision and prioritised recovery and resolution planning requirements. The SPM module CA-B-2 complements the Banking (Capital) Rules, which empower the MA to determine HLA requirements applicable to locally incorporated AIs designated by the MA as D-SIBs or G-SIBs under the Banking (Capital) Rules. CA-B-2 sets out the MA’s approach to assessing the systemic importance of AIs and describes the supervisory measures to be applied to AIs assessed to be G-SIBs or D-SIBs. The key sections of the SPM module cover:

- Overview of the D-SIB framework;
- MA’s approach to D-SIB identification;
- Consequences of being identified or designated as a D-SIB;
- Announcement of D-SIBs;
- Disclosure requirements applicable to D-SIBs; and
- MA’s approach to G-SIB designation

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- **Supervisory Policy Manual (“SPM”) CA-G-1: “Overview of Capital Adequacy Regime for Locally Incorporated Authorized Institutions” (Revised)**

The HKMA has issued by notice in the Gazette a revised version of the SPM module “Overview of Capital Adequacy Regime for Locally Incorporated Authorized Institutions” as a statutory guideline under section 7(3) of the Banking Ordinance. The revisions update the module to reflect the current regulatory capital requirements (as contained in the Banking Ordinance, the Banking (Capital) Rules (BCR), the Banking (Disclosure) Rules and the relevant supervisory guidelines issued to date) as well as the supervisory process to ensure compliance. In particular, paragraphs 6.1.2 to 6.1.6 of the revised module provide guidance on the procedures to be followed by authorized institutions to ensure a capital instrument proposed to be included as Additional Tier 1 capital or Tier 2 capital meets all of the qualifying criteria specified in Schedule 4B or 4C to the BCR. The opportunity has also been taken to clarify a couple of issues (relating to the application of section 33(1) of the BCR and the capital buffers) identified in the recent assessment by the Basel Committee of Hong Kong’s compliance with the Basel 2/2.5/3 standards under the Committee’s Regulatory Consistency Assessment Programme (see paragraphs 4.6, 13.1 (in respect of capital plan) and 13.2 of the revised module).

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- **Refinement of the Renminbi Liquidity Facility**

In the light of operating experience, the HKMA adjusted the calculations for interest on the intraday and overnight funds provided under the RMB Liquidity Facility with effect from 2 March 2015. The refinements are as follows:

1. The repo rates to be applied on the overnight repo will be changed to the average of the most recent 3 TMA overnight CNH HIBOR fixings (inclusive of the fixing on the same day) plus 50 basis points.
2. The repo rates to be applied on the intraday repo will be changed to the average of the most recent 3 TMA overnight CNH HIBOR fixings (inclusive of the fixing on the same day).
3. Any intraday repo not repaid before 11:30pm each day will be automatically converted into an overnight repo. The overnight repo will be subject to a full overnight interest charge, based on the formula for overnight repo above, while interest charge on the relevant intraday repo will be waived.

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- **Supervisory Policy Manual (“SPM”) CG-5: “Guideline on a Sound Remuneration System” (Revised)**

Following consultation with the two industry Associations, the HKMA issued a revised version of the above SPM module in the form of guidance note. The revised module formally incorporates the relevant disclosure standards issued by the Basel Committee on Banking Supervision in its July 2011 paper on Pillar 3 disclosure requirements for remuneration (the "BCBS disclosure standards")¹. Pursuant to section 52(ba) and (c) of the Banking (Disclosure) Rules, locally incorporated authorized institutions must disclose the extent of their compliance, and explain any areas of non-compliance, with the disclosure requirements in CG-5.

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- **Guidance Paper on Anti-Money Laundering Controls over Tax Evasion**

The HKMA has developed a guidance paper for authorized institutions on anti-money laundering controls over tax evasion. The practices outlined in this guidance paper will assist AIs in not only meeting the legal and regulatory obligations under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance but also enhancing the effectiveness of measures to mitigate their money laundering risks in respect of tax evasion. AIs are expected to give full consideration to the adoption of the practices set out in the paper, where necessary, taking into account their money laundering risks in respect of tax evasion.

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