

Risk Management and Regulation Newsletter

Welcome to the Risk Management and Regulation Newsletter

Welcome to the fifth issue of this newsletter. As always, there is a lot going on in the areas of risk and regulation for Banks and FIs in Hong Kong.

In this issue we will discuss:

- **Climate Risk:** First up is climate change. While many of us will surely look back on 2020 as the year of COVID, the other significant development was the increasing urgency of calls to action on climate change. Many banks are making a response to climate change a key part of their purpose. We are also seeing regulators, including the HKMA, responding to this and bringing in guidelines on how Banks manage climate risk, particularly within their credit and lending policies.
- **SFC Bookbuilding Activities:** The SFC continues to look closely at the role of Banks and other intermediaries in the capital markets and have issued a consultation on strengthening requirements on bookbuilding and placing activities across both ECM and DCM activities. The SFC has been historically focused on sponsors but now appear to be looking at the conduct of intermediaries in this area. As well as amending policies and procedures, we would envisage a need to ensure the effective operationalisation of any changes to allow senior management to demonstrate they have met any guidance which is introduced.
- **IBOR Reform:** This continues to move relentlessly towards the withdrawal of the old IBORs and their replacement with alternative reference rates. There is a lot of developments highlighted here including a number of initiatives to promote more liquidity and activity in alternative reference rates. We would see this momentum continuing in the rest of 2021.
- **AML/CFT and Sanctions:** A newsletter on regulatory matters would not be complete without a discussion of AM/CFT. The main development we expect to continue to see in 2021 is increasing use of technology to allow banks and FIs to achieve better outcomes. The HKMA is taking a leading role in encouraging wider adoption of new technologies – in particular how to leverage the data many Banks have collected over years.

We hope you find this issue informative and look forward to hearing your feedback.



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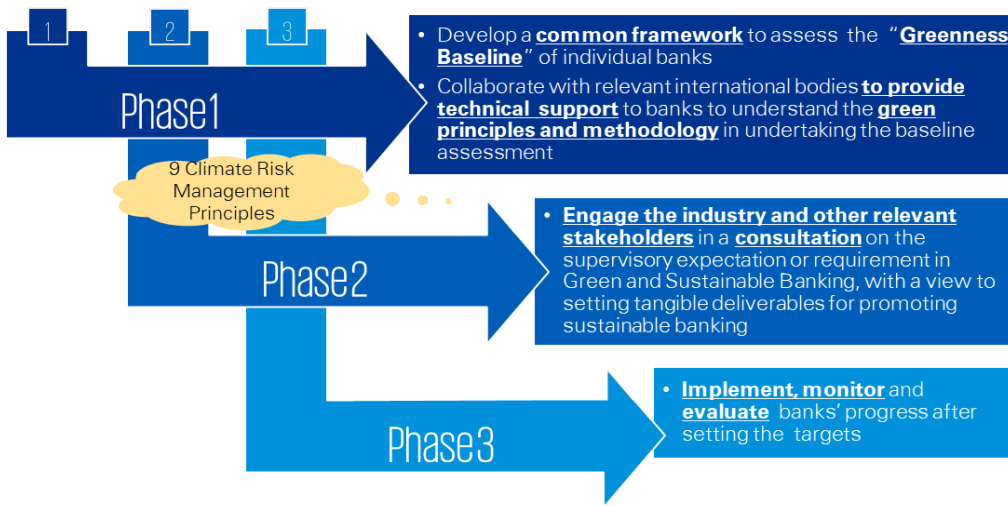
Topics in this issue:

1. Climate Risk
2. SFC Bookbuilding Activities
3. IBOR Reform
4. Anti-Money Laundering / Counter-Financing of Terrorism and Sanctions

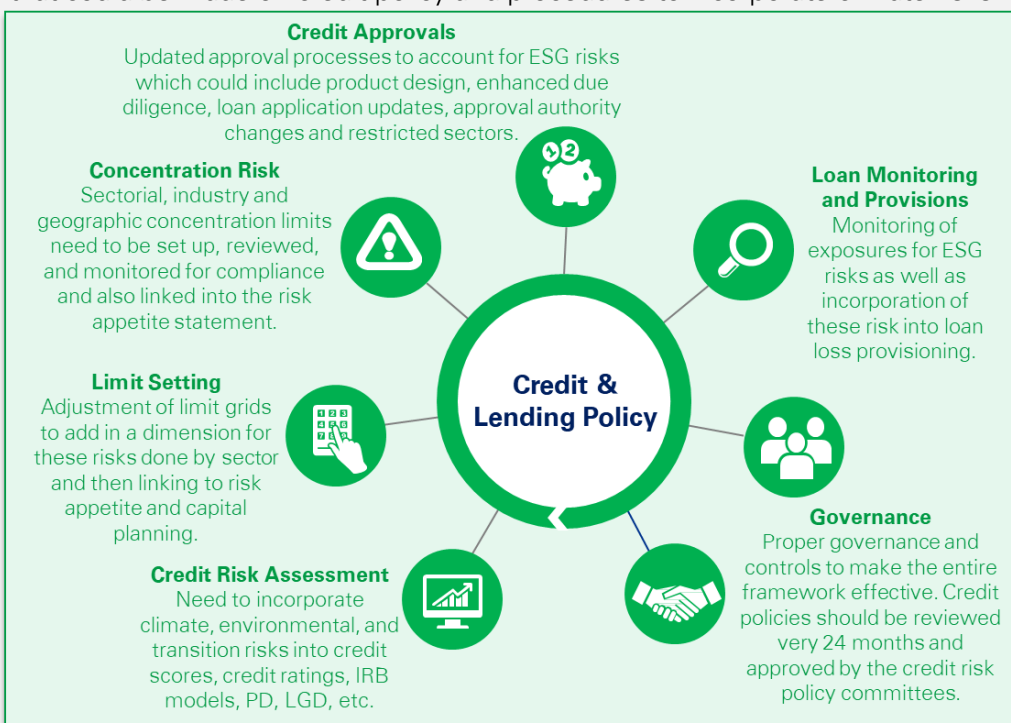
Climate Risk

Climate change is one of the major risks threatening the well-being of mankind. How the banking and financial system operates will clearly have an impact on the way in which climate risk is managed or reduced. The HKMA is committed to promoting green and sustainable finance in order to address climate risk.

May 2020: HKMA releases first output under Measure 1 – the Common Assessment Framework. Information gathered will be key input to developing the supervisory expectations



Almost all of the components of banks' risk management will need revision to incorporate climate risks, including all levels of policies, procedures, methodologies and infrastructure. This includes updating stress tests for each risk type (credit, market and operational), such as adding a severity multiplier or adding a risk factor for climate risk. The diagram below outlines enhancements that could be made on credit policy and procedures to incorporate climate risks.



Jun 2020

Consultative Document Principles for operational resilience Banking



9 Guiding Principles:



1 Board Accountability in Climate Resilience



2 Board's Oversight of Climate Strategy Development & Implementation



3 Strategy Formulation



4 Strategy Implementation



5 Risk Identification



6 Risk Measurement



7 Risk Monitoring & Reporting



8 Risk Exposre Control & Mitigation



9 Disclosure of Climate Related Information



Click [here](#) for the White Paper on Green and sustainable Banking the HKMA published in June 2020, outlining its initial thinking about supervisory approaches to address climate-related issues.

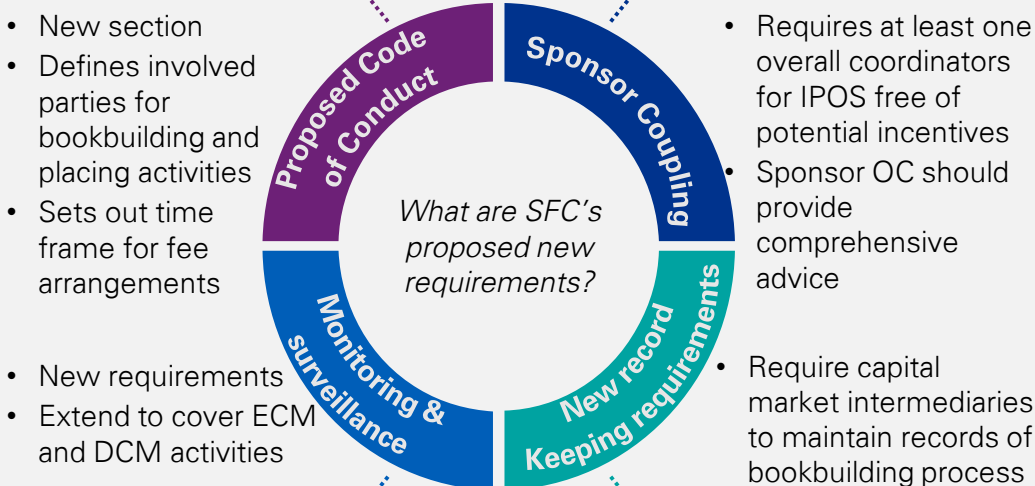
SFC consultation paper on new requirements for equity and debt bookbuilding and placing activities

On 8 February 2021, the SFC issued a consultation paper on proposed conduct requirements for capital market transactions in Hong Kong. The proposed requirements are designed to strengthen the Hong Kong capital markets by clarifying the roles played by intermediaries in equity and debt capital raisings and setting out the standards of conduct expected of them in bookbuilding, pricing, allocation and placing activities.

The SFC's thematic review of licensed intermediaries engaged in equity capital market (ECM) or debt capital market (DCM) activities and engagement with both buy-side and sell-side participants focused on the state of the market as well as the practices and conduct of intermediaries.

The thematic review identified the following issues with current market practices:

- Lack of clarity on the roles and responsibilities of intermediaries engaged in capital raising in Hong Kong
- Deviations from accepted market practices on syndicate membership and fee arrangements
- Placing by intermediaries of knowingly inflated orders which undermines the price discovery process
- Lack of transparency in the order book
- Preferential treatment or rebates paid to investors
- Lack of written documentation by heads of syndicate



Feb 2021

Consultation paper
on proposed
requirements

The consultation period ends in May 2021 and whilst there is no timeline on implementation, the SFC has stated that they will give a **six month implementation period**.



Click [here](#) for the full paper KPMG published in February 2021, which includes further details of the issues the SFC is aiming to address, who will be affected, and what the proposed new requirements are.

Updates on benchmark interest rates

Regulatory Updates

Singapore sticks to end-2021 goal for LIBOR shift despite delays

The Singapore committee set out key steps to further advance for the transition to a Singapore Overnight Rate Average (SORA). It has reaffirmed previous guidance for lenders and borrowers to cease using the SGD swap offer rate (SOR), for which USD LIBOR is a component, for new SOR-linked cash market products by end of April 2021. This will promote the SORA market liquidity and demand in SORA-linked products, especially when MAS provides further guidelines.

Industry Updates

OCC releases LIBOR self-assessment tool

The Office of the comptroller of the Currency (OCC) has provided this tool for banks to evaluate their preparedness for the expected cessation of the LIBOR. It can serve as a checklist and help banks to assess the readiness in (1) exposure assessment and planning, (2) replacement rates, (3) fallback language and (4) progress and oversight.

IBA launches new USD reference rates webpage to assist with USD LIBOR transition

The ICE Benchmark Administration (IBA) launched this webpage to provide an accessible and transparent way for the market to compare and view difference reference rates the IBA is developing daily. This is a useful resource for authorized institutions (AIs) to access the historical data and rate comparison to assess their risk and pricing models or perform sensitivity tests. As advised by the IBA, the data should not be used for actual pricing of new ARR products as the information is solely for information and illustrative purposes.

New ISDA IBOR fallbacks take effect for derivatives

Since 25 January 2021, the fallbacks published by the International Swaps and Derivatives Association (ISDA) will be incorporated into all new derivatives contracts referencing the ISDA's standard interest rate derivatives definitions. The protocol has no cut-off date yet and covers not only LIBOR but also IBORs in different jurisdictions. Banks should monitor and check if their confirmation templates for LIBOR-linked derivatives have already incorporated the guidelines announced by the ISDA to include fallback terms in the confirmation or contract.

New Developments on Products and Pricing Strategy

OCBC Bank completes two USD corporate loans referencing SOFR

The two loans are the first SOFR loans for the Hong Kong Branch, and is another milestone towards adopting ARRs. Liquidity is expected to increase in Hong Kong's loan market over the next few months as more AIs are able to offer products referencing the ARRs.

2021

LIBOR ceases at
end of 2021

Three key SORA initiatives by the Singapore committee:

- I. Central clearing of SORA derivatives for transactions will be extended from the current 5-year to the 21-year tenor;
- II. The MAS SORA derivatives auction parameters will be expanded to cover more key industry participants, and transaction tenors will be extended from the current 5-year to the 20-year tenor; and
- III. The MAS SORA floating rate notes programme will be expanded from the current 6-month tenor to include 1-year and 2-year tenors.

Click [here](#) for all the issues of KPMG's monthly LIBOR newsletter, which provides updates on LIBOR and other benchmark interest rate developments that directly impact banks and considers the potential implications of the related regulatory requirements.

Hong Kong Regtech implementation case studies and past experiences

As an ongoing initiative of the Hong Kong Monetary Authority (“HKMA”) to promote Regulatory Technology (“Regtech”) adoption in Anti-Money Laundering and Counter-Financing of Terrorism (“AML/CFT”) areas specifically to banking sector, the HKMA published a [report](#) in January 2021 sharing case studies and past experiences of Regtech implementation. This report is the latest in a series of publications by the HKMA on Regtech, including a [Regtech whitepaper](#) jointly issued with KPMG in November 2020 that outlines a roadmap to accelerate adoption of Regtech in the banking sector.

The report concluded past experiences from the AML/CFT Regtech adoption journeys of Authorized Institutions (“AIs”) of different sizes and business scopes, which were grouped into five themes:

- (i) getting started – how to kick-start a Regtech initiative;
- (ii) data and process readiness – how to anticipate and utilise the data that AIs have been collecting for years to fulfill the requirements of Regtech;
- (iii) third-party vendor relationships – how to assess whether the vendor provides Regtech solutions that are applicable to the AIs needs;
- (iv) people, talent and culture – how to identify specific skills from AML/CFT leaders to encourage innovation and adoption of new and emerging technologies; and
- (v) performance metrics and indicators – how to define and track the value and performance for their investments into AML/CFT Regtech.

Securities and Futures Commission (SFC) concludes consultation on customer due diligence (CDD) requirements for open-ended fund companies (OFCs)

The SFC released [consultation conclusions](#) on the proposed CDD requirements for OFCs in December 2020. This is the conclusion of a further consultation issued in conjunction with the conclusion of a previous [consultation](#) in September 2020 which was also focused on the CDD requirements on OFCs.

The SFC concluded that it will implement the proposal to require OFCs to appoint a responsible person to carry out AML/CFT functions, in line with the international standards and a transition period of six months will be allowed before the new requirements come into effect.

In addition, a previous consultation on the amendments to the SFC’s AML guideline had closed in December 2020 and the SFC is expected to issue a revised version of the guideline within 2021.

Anti-Money Laundering / Counter-Financing of Terrorism and Sanctions



Takeaways from HKMA report on RegTech implementation:



Significant opportunities for banks to further adopt established solutions in AML/CFT



Boost wider awareness on use of data analytics techniques



HKMA will continue to share Regtech-related expectations and guidance



SFC’s consultation on CDD requirements



Amendments on CDD requirements for OFCs



Appoint responsible person to carry out AML/CFT functions



New requirements to come into effect after a six-month transition period

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