

# Risk Management and Regulation Newsletter

## Welcome to the Risk Management and Regulation Newsletter

Welcome to the sixth issue of this newsletter. The risk and regulatory environment for Banks and financial institutions in Hong Kong continues to be active.

A trend that we at KPMG expect to be increasingly prevalent is **Regtech**. The HKMA has been very active in the last few months on this topic with a Regtech Event on 30 June 2021 and the launch of the first in a series of Regtech Adoption Practice Guides. The first guide considered cloud-based solutions and gave practical guidance for Banks in Hong Kong on matters to consider when adopting such solutions. Cloud computing is key to greater Regtech adoption in many areas as it allows effective and efficient processing of a lot of data – key to many Regtech solutions. It is also an area where Banks are keen to explore the benefits but are always mindful of the Hong Kong Monetary Authority's (the HKMA) view – having some practical guidance from the HKMA will help the industry.

The target date for **implementation of the final Basel III measures** has been extended. It is worth noting that Hong Kong has generally been timely in implementing the Basel III measures in accordance with BCBS/FSB timelines but that is not always the case for other jurisdictions. While the implementation of these measures has been long and costly, some would say they have shown their worth in the last 18 months with Banks not facing capital or liquidity issues during the COVID-19 pandemic.

We also summarised the key matters noted in the **HKMA's Annual Report for 2020**. On the supervision side, the key matters remain similar. One development that is worth noting is an increasing focus by the regulator on Supervisory Technology or SupTech. The HKMA is increasingly going to become a much more data-driven, analytical regulator in the future, which brings challenges to banks in terms of their ability to ensure the quality of data and employ their own analytics to 'front run' the HKMA's supervisory processes.

Lastly we also highlight that the FSTB published the results of its consultation on the **regulation of Virtual Asset Service Providers (VASPs)**. Going forward VASPs will be regulated by the SFC bringing this new part of the financial services eco-system into the sphere of regulation for the first time.

As always we hope you value our insights and we would be happy to discuss any of these matters in more detail with you.



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### Topics in this issue:

1. Regtech Adoption
2. Revised Basel III Implementation Timeline
3. HKMA Annual Report 2020
4. Anti-Money Laundering / Counter-Financing of Terrorism and Sanctions

# Regtech Adoption - Cloud-based Regtech Solutions

The HKMA recently launched a new [Regtech Adoption Practice Guide series](#) to provide banks with detailed practical guidance on the implementation of Regtech solutions.

The publication of the Regtech Adoption Practice Guide series forms part of the HKMA’s [two-year Regtech promotion roadmap](#) announced in November 2020. Each Guide focuses on a specific technology or application area identified in the HKMA’s White Paper to further Regtech adoption in the Hong Kong banking sector. The inaugural issue provides guidance on “Cloud-based Regtech solutions”.

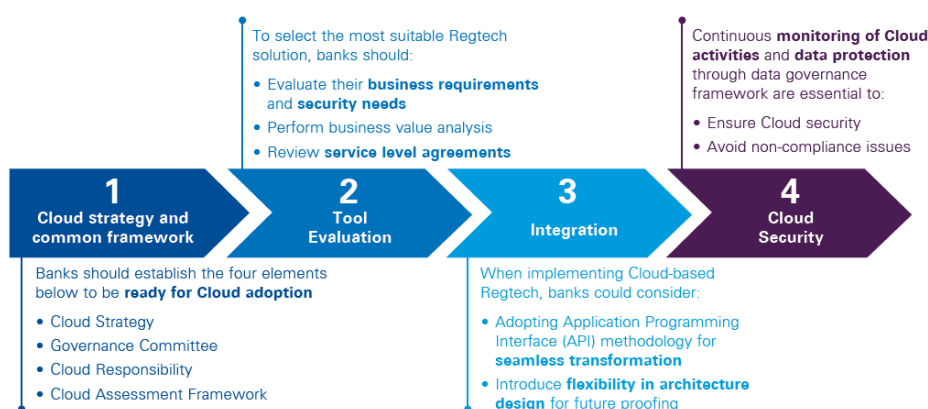
The first issue of the Practice Guide explores how Cloud computing is a key underpinning technology behind Regtech solutions. The use of Cloud technology on Regtech solutions offers several benefits including timely offsite support, fast implementation and highly scalable solutions. The Guide

1. Explains how Cloud-based Regtech solutions can be used to support risk management and compliance
2. Provides practical implementation guidance to banks on the adoption of Cloud-based Regtech solutions
3. Shares use cases on the adoption of Cloud-based Regtech solutions

Table 1: Regtech solutions under each Cloud service model

	IaaS	PaaS	SaaS
Model	Infrastructure as a Service	Platform as a Service	Software as a Service
<b>Description</b>	A service model that provides on-demand computing, storage, and network services	A platform that facilitates development, deployment and orchestration and delivers necessary tools for development	A Cloud-based service that provides tools ranging from specific software to analytic and management tools
<b>Regtech Application</b>	IaaS enables centralised data (e.g. data lakes) to be used for analytics and reporting. For Regtech applications, this enables quality data inputs with smoother data identification and extraction	PaaS offers managed services for the underlying platform infrastructure, and is often adopted to lessen the need for in-house technical expertise. A platform solution can cover comprehensive areas of risk management and compliance (e.g. an outsourced platform solution to manage the account opening process)	Most market-ready Regtech solutions are SaaS-based. These Regtech solutions can be delivered over a web browser, are easy to adopt, and feature automatic updates and offsite maintenance

Figure 1: Key components of Cloud-based Regtech implementation



Source: KPMG

Jun 2021

Launch of the Regtech Adoption Guide series



**Key barriers:**



1 Company policy and governance



2 Insufficient capability and experience



3 Legacy systems



**Key risks:**



1 Insufficient IT governance model and control



2 Compliance across jurisdictions



3 Data protection and disaster recovery



4 Vendor lock-in



Click [here](#) for the first issue of the Regtech Adoption Practice Guide series the HKMA published in June 2021, outlining the first issue on Cloud-based Regtech solutions.

## Revised Basel III Implementation Timeline

The HKMA recently released a [circular](#) outlining that in order to provide the industry with additional time to prepare for the implementation of the revised capital standards in the Basel III final reform package amid competing priorities, the HKMA is informing the industry about their intention to revise the target effective dates of the standards in Hong Kong as follows.

### Revised frameworks on credit risk, operational risk, output floor and leverage ratio:

These frameworks will take effect as minimum requirements from 1 July 2023 (instead of 1 January 2023)

### Revised market and CVA frameworks:

Locally incorporated AIs will be required to implement the new market and CVA risk frameworks for reporting purposes by 1 July 2023. The new framework will take full effect no earlier than 1 January 2024.

### Revised disclosure framework:

The disclosure requirements associated with the above revised frameworks will take effect according to the corresponding effective dates.

Revised Basel III Implementation Timeline

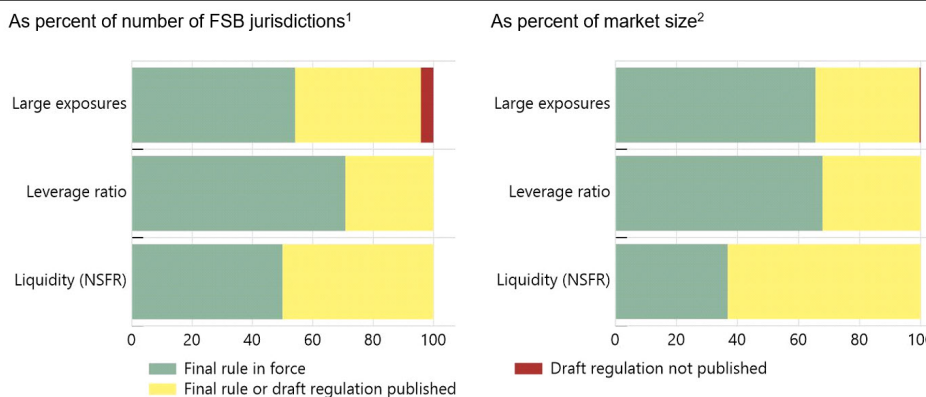
July 2023

Revised target effective date for Basel III implementation

To facilitate timely implementation, the HKMA aims to substantially **complete the drafting** of the rules by the **end of 2022**.

As outlined in the FSB’s [2020 annual report](#), the regulatory adoption of several core Basel III elements has generally been timely to date, but there are delays in some FSB jurisdictions especially around the leverage ratio, Net Stable Funding Ratio and the supervisory framework for measuring and controlling large exposures.

Implementation is behind schedule on certain Basel III standards Graph 1



<sup>1</sup> The five EU members of the FSB are presented as separate jurisdictions. <sup>2</sup> Market size based on assets of banks domiciled in each FSB jurisdiction at end-2018.



Click [here](#) for the HKMA circular announcing the revised Basel III implementation timeline.

# HKMA Annual Report 2020

The HKMA published its [annual report for 2020](#) including the financial statements of the Exchange Fund. The report reviews trends and major events in monetary and banking affairs, and reports on the HKMA's work during 2020. It also sets out the HKMA's work plans for 2021.

## 1 Monetary Stability

While the global economy is expected to recover in 2021 with COVID-19 rollout, the outlook remains uncertain and much will depend on the pandemic development. The HKMA will monitor risks and stand ready to deploy measures to maintain Hong Kong's monetary and financial stability. Research programmes in 2021 will study issues affecting the Hong Kong economy and assess potential risks.

## 2 Banking Stability

- Supervision of credit, operational, technology, liquidity and market risk
- Adoption of supervisory technology
- Promote smart banking through Regtech adoption, and green banking by mandating climate-related disclosures
- Continue multi-year programme to build an operational resolution regime for AIs

## 3 International Financial Centre

- Develop Hong Kong as a fintech hub in Asia
- Capitalise on the trend of Hong Kong as the dominant gateway to Mainland China and the global offshore renminbi business hub
- Strengthen international and regional cooperation
- Explore more potential applications to promote e-payment
- Implement the supervisory regime for SVF licences

## 4 Corporate Social Responsibility

The HKMA will continue to address climate change risks and promote green finance development, including setting supervisory expectations and requirements in the banking sector. The HKMA will also keep working to make banking services more accessible, and promote financial literacy and inclusion. Amid fluctuations in the pandemic, the HKMA will review and adjust effectiveness of existing support measures.

# April 2021

## Release of the HKMA's Annual Report for 2020



### Highlights of 2020:



#### Economic & Financial Environment

The Hong Kong economy contracted by most severe magnitude on record.



#### Monetary Stability

Hong Kong's year-end monetary base was HKD 2.1 billion.



#### Banking Stability

Total assets: HKD 25.9 trillion  
Loan growth: 1.2%  
Capital adequacy: 20.7%



#### International Financial Centre

Largest offshore RMB liquidity pool (757 billion)  
7 million FPS registrations  
64 million SVF accounts



#### Reserves Management

EF investment income: HKD 236 billion  
Assets: HKD 4.5 trillion  
Investment return: 5.3%



#### Corporate Functions & Social Responsibility

HKMA enhanced public understanding of its policies, and introduced various COVID-19 relief measures.

## Hong Kong Monetary Authority (“HKMA”) Regtech initiatives

The HKMA hosted its flagship Regtech event – [“Unlocking the Power of Regtech”](#) on 30 June 2021. The event was attended by over 4,000 participants, involved global Regtech representatives sharing their experience and insights into the potential of Regtech, and announced the winners of HKMA’s [Global Regtech Challenge](#). Mr. Eddie Yue, Chief Executive of the HKMA, emphasised in his [opening remarks](#) that Regtech constitutes an important driver of the HKMA’s [‘Fintech 2025’ strategy](#) and set out four actions to transform bank attitudes and practices towards Regtech: (i) understand the Regtech landscape evolution; (ii) raise Regtech awareness; (iii) encourage new Regtech solutions; and (iv) expand the Regtech ecosystem, particularly the nurturing of talents.

To achieve these actions, the HKMA commissioned KPMG to write the [“Transforming Risk Management and Compliance: Harnessing the Power of Regtech”](#) white paper published on 3 November 2020 and the [Regtech Adoption Index 2020](#) (“RAI”) published on 30 June 2021. The RAI describes the current level of Regtech adoption among banks in Hong Kong as well as their preparedness and intent to adopt, and indicated that 56% of the surveyed banks have applied Regtech to at least two regulatory themes identified in the 3 November 2020 white paper, particularly in financial crime. The RAI provides three key actions to banks further Regtech adoption: (i) develop a Regtech strategy and assign/establish Regtech leadership roles; (ii) foster Regtech expertise, and; (iii) engage with the Regtech ecosystem.

In addition, HKMA also launched the Regtech Adoption Practice Guide (“Regtech APG”) series to provide banks with detailed practical guidance on the implementation of Regtech solutions. The first issue of [Regtech APG](#) is on cloud-based Regtech solutions, and there will be another issue on financial crime to be released in the near future.




## AML/CFT legislation public consultation conclusions

In May 2021, the Financial Services and Treasury Bureau published the [consultation conclusions](#) on enhancing the AML/CFT regulations in Hong Kong, particularly in relation to the licensing of virtual asset services providers (“VASPs”), dealers in precious metals and stones (“DPMS”) registration regime, and other amendments in respect of the AML Ordinance (Cap. 615).




Chapter 2 of the publication consolidated the proposed requirements on the licensing regime for VASPs in Hong Kong. Chapter 3 of the publication proposed a two-tier registration regime for DPMS based on a risk-based approach. Chapter 4 of the publication proposed miscellaneous amendments on AMLO to address technical issues identified in the FATF’s Mutual Evaluation Report on Hong Kong, including but not limited to the definition of “politically exposed person” in accordance with the FATF requirement, aligning the definition of “beneficial owner” in relation to a trust, and allowing digital identification systems to conduct customer due diligence processes.

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

### Implications on HKMA Regtech recently published initiatives

-  Banks to adopt Regtech as part of ‘Fintech 2025’ strategy
-  RAI provides an outlook of the Regtech environment among banks
-  Regtech APG provides detailed guidance to help banks implement Regtech solutions

### Takeaways from FSTB consultation conclusion:

-  Licensing regime requirements proposed for VASPs
-  Two-Tier Registration Regime for DPMS
-  Miscellaneous amendments to AMLO to address FATF findings

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