HONG KONG MONETARY AUTHORITY
香港金融管理局

Our Ref : B1/21C
B1/15C

31 December 2010

The Chief Executive
All Authorized Institutions

Dear Sir / Madam,

Supervisory Policy Manual (SPM)
IC-1 "General Risk Management Controls"

I am writing to inform you that, following consultation with the two industry Associations, the Monetary Authority is issuing today a revised version of the above-mentioned SPM module as a statutory guideline by notice in the Gazette under section 7(3) of the Banking Ordinance.

As part of the process to enhance its supervisory framework and guidelines in the aftermath of the global financial crisis, the HKMA has updated the SPM module to reflect changes in international standards and practices in response to lessons learned from the crisis. The changes to the module mainly relate to general risk management issues that have firm-wide implications, having regard to relevant risk management deficiencies identified in relation to those banks more adversely affected by the crisis. These include, for example, the lack of a comprehensive approach to managing firm-wide risks; ineffective risk management oversight by the Board of Directors and senior management in risk identification, analysis and monitoring; and inadequate information and system infrastructure to support the broad management of financial risks. Other risk-specific issues have been or are being addressed in the relevant SPM modules for individual risks (including counterparty credit risk, liquidity risk, and market risk).

Highlighted below are the major areas of change in the module, many of which build upon existing guidance and concepts already embedded within it.

Risk management governance

The revised module reinforces the risk management responsibilities of the Board and senior management of an AI and the need for them to put in place sound risk governance arrangements. Members of the Board and senior management are expected to possess adequate knowledge and understanding of the material risks faced by the AI (including those associated with any complex and high risk activities); dedicate sufficient time and effort to overseeing and participating in the AI's risk management process; maintain continued awareness of the AI's risk profile and of developments that may lead to emerging risks; and ensure the effectiveness of independent risk management and control functions.

The Board and senior management of an AI should also promote continuous and robust dialogue and information sharing among members of senior management, business lines, and risk management and control functions so that sources of significant risk to the institution as a whole can be promptly identified, analysed and mitigated.

Firm-wide risk management

The revised module stresses the importance of an AI having a sound firm-wide risk management framework which enables the AI to set its risk appetite and tolerance, and supports the Board and senior management both in managing risk from an integrated, firm-wide perspective and in identifying and reacting to emerging and growing risks in a timely and effective manner. More guidance is provided, in particular, on the following aspects:

(i) the articulation of, and the monitoring of adherence to, the risk appetite approved by the Board;

(ii) the establishment of a comprehensive and independent risk management function to coordinate risk management activities across the institution;

(iii) the development and implementation of firm-wide risk management policies and procedures that provide for –

- objective and consistent risk identification and measurement approaches;
- sound valuation and stress-testing practices; and
- effective risk monitoring measures and controls;

(iv) the process and procedures for approving new products and services as well as significant changes to existing products and services;

(v) the key elements of an effective risk management information system to support firm-wide risk oversight; and

(vi) the use of risk measurement models or methodologies for risk assessment and analysis, bearing in mind their practical and conceptual limitations as well as inherent assumptions.

Information system and infrastructure

AIs are expected to have in place a management information system with sufficient technological support and processing capacity (including in times of stress) to effectively measure and report on the risks of major functions, products or business activities within the institution. To enable proactive risk management, the system should be adaptable and responsive to changes in the assumptions used for risk management and aggregation; be capable of incorporating multiple perspectives of risk exposure to account for uncertainties in risk measurement; and be sufficiently flexible to allow for the generation of forward-looking firm-wide scenario analyses that capture management's interpretation of evolving market conditions and stressed conditions.

Internal audit and compliance functions

The revised module provides expanded guidance on the key attributes and responsibilities of the internal audit and compliance functions, the effectiveness of which is important for ensuring the integrity of an AI's overall risk management process.

The standards laid down in the revised module will be applied to all AIs on a proportionate basis, having regard to their size, nature and complexity of operations. Given that the changes incorporated into the module are crucial for effective risk management, AIs will be expected to bring themselves in line with the revised module without delay. Nevertheless, if individual AIs need more time to complete system and process changes for implementing specific aspects of the guidance, they may discuss and agree with the HKMA an implementation plan and timetable for the aspects concerned.

On-line access to the SPM module is available to AIs under the icon for "Supervisory Policy Manual" on the HKMA's public (http://www.info.gov.hk/hkma) and private (http://www.stet.finnet.hk/index.htm) websites.

Should you have any questions relating to the module, please contact Rita Yeung at 2878-1388 or Polly Yan at 2878-1528.

Yours faithfully,

Karen Kemp
Executive Director (Banking Policy)

c.c. The Chairman, Hong Kong Associations of Banks
The Chairman, The DTC Association
FSTB (Attn : Ms Natalie Li)