



Hong Kong Branch

a banking corporation (having limited liability)  
incorporated in the State of California in the United States of America

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## **Operational Risk Disclosure Statement – Hong Kong Branch (As of December 31, 2023)**

The information contained in this disclosure statement is for Cathay Bank Hong Kong Branch (“the Branch”) and is prepared in accordance with the Supervisory Policy Manual (“SPM”) OR-1 on Operational Risk Management issued by the Hong Kong Monetary Authority (“HKMA”).

### **PART I: OVERVIEW**

This report represents a thorough and detailed disclosure of the operational risk exposures and operational risk management of the Branch. It complies with the guidance provided by SPM OR-1 on Operational Risk Management issued by the HKMA. By presenting this information, the report aims to provide stakeholders with a comprehensive understanding of the approach the Branch adopted to manage its operational risks and exposure. Ultimately, the report serves as a valuable tool for stakeholders to assess the Branch’s resiliency in delivering critical operations through disruptions and determine whether the Branch identifies, assesses, monitors and controls/mitigates operational risk effectively.

### **PART II: OPERATIONAL RISK - Disclosure Related to Operational Risk**

#### ***Overview of Operational Risk***

Operational risk is inherent in all banking products, activities, processes, and systems. The capital standards issued by the Basel Committee on Banking Supervision (“BCBS”) define operational risk as “the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events”. This definition includes legal risk but excludes strategic and reputational risk. Where appropriate, strategic and reputational risks should be taken into consideration under the Operational Risk Management Framework (“ORMF”).

The increasing scope and complexity of products and services, processes, and systems, and changing external environment have made the Branch’s risk profile more sophisticated. Failure to responsibly manage operational risk may bring significant losses to the Branch. As such, the Branch has developed its ORMF to promote a proactive and consistent operational risk culture on a continuous basis to address the ever-changing operational risk landscape and ensure its long-term sustainability in the local banking sector. The ORMF provides the standards and guidelines to identify, measure, monitor, and control or mitigate operational risk in relation to the Branch’s daily activities. It defines the environment and organizational components for managing operational risk in a structured systemic and consistent manner to align with the Bank’s risk appetite, as well as the related risk policies and procedures outlining roles and responsibilities, data standards, risk assessment processes and methodology, and reporting standards.



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## **Governance**

### Governance Structure

The governance structure of the Branch's operational risk management is divided into three levels:

The Board of Cathay Bank ("Bank") is the highest decision-making body for enterprise risk management, and has ultimate risk management responsibility for the Bank. The Bank's Board delegates the Risk and Compliance Committee ("RCC"), a Board-level committee, to perform monitoring and supervision duties in relation to the Branch's management of operational risks and strategies, which include:

- Overseeing the development and implementation of operational risk management and control processes and the integration of operational risks into the existing risk management framework;
- Monitoring and managing operational risks such as through the review and approval of the Branch's Operational Risk Management Policy;
- Establishing an operational risk governance structure within the Branch's ORMF;
- Structuring clear lines of management responsibility and accountability for managing operational risk.
- Defining the oversight structure and articulating the roles of the individual stakeholders; and
- Regularly assessing the Branch's operational risk profile and monitoring the implementation of actions to manage the operational risks, including mitigation measures.

The Branch's Risk Management Committee ("RMC") is responsible for maintaining a sufficient understanding of operational risks among all team members to ensure decisions made are consistent with operational risk management strategies and risk appetite. Operational risk governance responsibilities include:

- Implementing the ORMF and advance the process of operational risk management;
- Formulating operational risk management policies, strategies, risk appetite, and major risk limits, including measurement and assessment methods and stress testing methods in accordance with the operational risk limit management mechanism specified in this policy, for the Board's approval and perform review on the aforesaid policies and risk limits on regular basis (at least on an annual basis);
- Reviewing the remedial actions for the breach of the operational risk limits;
- Establishing an effective escalation process for reporting adverse operational events, significant risks and exceptions; and
- Escalating significant risks/exceptions to RCC via the Bank's Chief Risk Officer and seeking the Board's approval.

The respective functional departments/units, including Chief Executive, Department Heads, Risk Officer and General Compliance Department of the Branch are responsible for the execution of operational risk management under their respective risk areas.



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Three Lines of Defense

The Branch’s risk governance framework provides clear oversight and ownership of management of operational risk across three lines of defense. The three lines of defense model outlined in the Bank’s Enterprise Risk Management Policy is used as the primary means to demonstrate and to structure roles, responsibilities, and accountabilities of various parties for decision-making, risk management and control. The first line of defense comprises business lines and operational functions whereas the second and third lines of defense involve independent risk management and control functions (i.e., General Compliance (“GC”), Assets and Liabilities Management Committee (“ALCO”), RMC, etc.) and audit functions (i.e., internal & external audits) respectively.

<b>Defense</b>	<b>Role</b>
First Line of Defense – Lines of Business	Owns and manages operational risk.
Second Line of Defense – Independent Risk Management and Control Functions	Oversees and monitors operational risk.
Third Line of Defense – Internal Audit and Loan Review	Provides independent assurance of management’s adherence to approved policies and regulations. Conducts audits and reviews.

Internal Guideline and Policy

The Branch has established the Operational Risk Management Policy – Hong Kong Branch to create a framework for managing operational risks effectively. This policy outlines the processes, key components and implementation of the ORMF, and sets up the standards for identifying, measuring, monitoring, reporting and managing operational risk across the Branch in a consistent manner.

Based on the principles and framework established by this policy, the Branch has also reviewed and updated its internal policies to account for operational risk considerations appropriately and uphold risk ownership and accountability in terms of operational risk management, supported by the risk and control functions of General Compliance.

**Strategy**

Operational Risk Management Strategy

The Branch’s operational risk management begins with the determination of the overall risk management strategies defined by the Bank’s Board including, but not limited to, risk appetite or tolerance, and ensures that the defined strategy aligns with the overall business objectives and risk management process.

The Branch places significant emphasis on operational risk management in its current strategy development process, encourages clear understanding and effective communication, and establishes a process to define and document relevant operational risks, their root causes and lessons learnt to strengthen its resiliency towards operational risk and disruptions.



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The Branch keeps on effectively implementing strategies on operational risk management, where appropriate, organizational structures, business processes, compensation systems, and resource availability need to be considered to ensure that operational risk management strategies are integrated into the Branch's daily operational activities and business development.

### *Operational Risk Identification*

The methodologies and practices used are integral parts of a consistent and proactive risk culture. They focus on managing the operational risk by providing a comprehensive and consistent approach across various functional departments and units and facilitating the pursuance of business objectives in a risk-controlled manner.

The Branch considers every aspect of its objectives when dealing with operational risk. It takes a proactive approach to avoid or minimize the possibility of operational disruptions. Operational risks are identified and assessed to ensure their alignment with the Bank's risk appetite and/or prompt implementation of actions being taken to manage the risks.

### ***Risk Management Process***

The Branch has established a mechanism to manage and control operational risk effectively according to the regulatory guidance and the Bank's policies. The Branch's operational risk management process incorporates the end-to-end approach of managing operational risk at various stages. The Branch has formulated effective means to regularly identify, assess, monitor, and control the operational risk inherent in its products, activities, processes, and systems in a timely manner.

The Branch reviews and enhances the granularity of assessments to evaluate the quality and appropriateness of corrective and mitigation actions and ensures that adequate controls and systems are in place to identify and address problems before they become major concerns.



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The following table is a description of the Branch’s operational risk management process:

Process	Description
<p>Risk Identification and Assessment</p>	<p>Several tools are used for identifying and assessing operational risk inherent in existing or new products and services, business activities, operational processes, and systems, including but not limited to, event management, operational risk event data analysis, self-assessment, control monitoring and testing, monitoring risk metrics, etc.</p> <p>When appropriate, the Branch takes into consideration the results of the operational risk assessment tools as criteria in the development of its internal pricing and performance measurements.</p>
<p>Risk Monitoring and Reporting</p>	<p>The Branch has a risk monitoring and reporting process to monitor its operational risk profile and material exposure to operational losses on an on-going basis. The process includes both qualitative and quantitative assessments of the Branch’s exposures to key types of operational risks to identify and address problems before they become major concerns.</p> <p>Key operational risk indicators and metrics are implemented to assess and measure the operational risk profile of individual functional department or unit, and that of the Branch. The Branch’s ORMF has built-in tools for systematically tracking and recording loss data, especially on its frequency, severity, and other relevant information on loss events.</p> <p>Risk reports, which contain the following types of information, including but not limited to operational risk events, results and analysis of operational risk metrics, Risk and Control Self-assessment (“RCSA”) results, internal audit findings, etc., are regularly submitted to the Bank’s Head Office and senior management for review and oversight.</p>
<p>Risk Control and Mitigation</p>	<p>The Branch has risk management measures to control and mitigate operational risk. Such measures include risk assessment, activities monitoring and control, communication and information sharing, training, establishment of departmental procedures, business continuity and disaster recovery planning, and insurance to cover possible losses resulted from operational incidents.</p>



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### Operational Risk Management Tools

To measure and manage operational risk effectively, the Branch uses the following tools to regularly monitor and assess its operational risk profile:

#### 1. RCSA

RCSA is a structured approach adopted by all functional departments or units of the Branch to assess its state of risk and control environment, and to undertake and implement specific action plans to address risk exposures so that business objectives are pursued in a risk-controlled manner. RCSA is used to proactively identify, assess, monitor, and control/mitigate operational risks inherent in their work processes, and serves to provide a robust and consistent approach to review the adequacy and effectiveness of the implemented controls to manage these risks.

#### 2. Operational Risk Library

The Risk Library contains all risk event frameworks and risk activities. Risk event frameworks are used to group risk activities into manageable categories, while risk activities group the individual operational risk incidents. The Risk Library is the central repository for all potential risks that could occur at anytime, anywhere in the Branch.

#### 3. Key Risk Indicators (“KRIs”) and Metrics

KRIs provide quantitative information about the Branch’s operational risk exposure and control environment. Metrics are management limits used to monitor major risk factors that could lead to business disruption, operational loss, reputational damage, financial crime, non-compliance or conduct issues. KRIs and metrics could help prevent the occurrence of related adverse events and provide valuable references for management decision making.

#### 4. Residual Risk Assessment

Residual risk is the amount of risk associated with an operational event/process remaining after controls have been applied. If the residual risk is assessed to be “High” or “Medium”, risk owner has to evaluate the situation, conduct business impact analysis, and recommend an alternative action (refer to the Risk Response Process section) to the RMC to respond to the risks.

#### 5. Operational Risk Event Data

The Branch sets up a comprehensive operational risk event dataset that collects all qualitative and quantitative information about internal and external operational risk events that it has experienced and serves as a basis for operational risk assessments. Where available, information on the root causes and control weaknesses for the events is documented and analyzed and serves as lessons learnt for team members, especially for those that are common among various functional departments or units of the Branch.

#### 6. Incident Reporting Process

Incident reporting and escalation is a process for analyzing operational risk incidents to identify lessons learnt and ensure proper actions are taken to address any operational risk management gaps. Significant operational risk incidents are escalated timely to the Senior Management and their impacts are consistently assessed.



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## 7. Products, Services and Vendor List

To assess the evolution of the risks associated with the change initiatives and to facilitate the monitoring of changes, the Branch maintains a central record of its products and services (including outsourced functions or activities) to the extent possible.

### Business Continuity Management and Disaster Recovery Plan

The Branch has established a Business Continuity Plan – Hong Kong Branch to promote sound business continuity management and ensure its operational resiliency in the event of disruption of critical operations. The Branch’s regular business continuity plan and disaster recovery testing exercises support its ability to prepare for and recover from disasters and limit losses in the event of severe operational disruption.

### Operational Resilience

Operational resilience refers to the Branch’s ability to deliver critical operations through disruptions. The Operational Resilience Policy – Hong Kong Branch develops an operational resilience framework which identifies three parameters (i.e., critical operations, tolerance for disruption, and severe but plausible scenarios) in compliance with the local regulatory guidance. The Branch conducts regular scenario testing for the identified critical operations to ensure its operational resiliency and ability to deliver critical operations through disruptions. In addition to the HKMA SPM module OR-1 “Operational Risk Management,” this policy has also considered relevant guidance issued by the HKMA in the SPM module OR-2 “Operational Resilience.”

### **Risk Response Process**

After the operational risk management process, the Branch evaluates the situation and chooses from the following alternative actions to respond to the identified risks:

Action	Description
Risk Mitigation	Reduce or eliminate risk through implementation of controls, or develop and implement mitigation action plans.
Risk Transfer	Transfer the risk partially or in full to a third-party (such as insurance coverage), or another business sector or area, or create a new risk (such as legal or counterparty risk).
Risk Avoidance	Develop and implement actions to avoid the risk.
Risk Acceptance	Decide to accept the risk and consequences within the Bank’s risk appetite and tolerance with risk acceptance approval in accordance with the Bank’s policies.



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***Operational Risk Exposure***

In 2023, the Branch did not have any significant operational loss events and there was no control identified with material weaknesses.