

(852) 2529 0121

(852) 2527 0790

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26 May 2003

***Fax: 2869 6794***

Clerk to Financial Affairs Panel  
(Attn: Ms Connie Szeto)  
Legislative Council  
Legislative Council Building  
8 Jackson Road  
Central  
Hong Kong

Dear Connie,

**Panel on Financial Affairs**

**Follow-up to meeting on 5 May 2003  
Agenda Item V – Clearing and Settlement Systems Bill  
Hong Kong Interbank Clearing Limited**

I refer to your letter of 6 May 2003 requesting the Administration to provide responses/information on the following -

- (a) the Hon. SIN Chung-kai's suggestion for Hong Kong Monetary Authority (HKMA) to sell its shares in Hong Kong Interbank Clearing Limited (HKICL) for segregation of duties after the enactment of the Bill; and
- (b) the international practices in clearing and settlement systems oversight to illustrate whether the oversight role of regulators in overseas jurisdictions were derived from both shareholding in clearing company and explicit legislative provisions at the same time.

Having consulted the HKMA, we would like to respond as follows –

### **HKMA's relationship with HKICL**

HKICL was established in 1995 as a private limited company, jointly and equally owned by the HKMA and HKAB (The Hong Kong Association of Banks). HKICL operates on a non-profit making basis and is the system operator for several major clearing and settlement systems in Hong Kong such as the Real Time Gross Settlement System.

### **Rationale for HKMA's stakeholder status in HKICL**

There are a number of reasons why HKMA was involved in the establishment and ownership of HKICL –

- (a) most central banks own and operate their high-value payment systems due to the systemic importance of such RTGS systems. In Hong Kong, HKMA does not operate the HK dollar RTGS system in-house but consigns the operation to the HKICL. In order to ensure that HKMA would have sufficient control over the operation and development of the HK dollar RTGS system, HKMA took a 50% ownership in HKICL;
- (b) financial market infrastructure is a public good and experience in Hong Kong suggests that there is often a market failure to develop such clearing and settlement services due to the substantial investments involved and the long-term nature of such investments;
- (c) HKICL is operated as a non-profit making company in order to provide cost-effective clearing and settlement services to Hong Kong. There is therefore little commercial interest in a stake in HKICL;
- (d) Data integrity and confidentiality at HKICL is very important given the amount of highly critical and confidential financial information processed at HKICL. Public confidence in the integrity of HKICL is enhanced by the stake taken by HKMA;

- (e) HKMA's shareholder role in HKICL has also helped to safeguard the various interests of a wide spectrum of users (including banks and other financial institutions) in areas such as tariff determination and development of payment services in Hong Kong; and
- (f) HKICL also undertakes system development work for HKMA as HKMA pursues its policy objective to promote the development of financial market infrastructure in Hong Kong. As a shareholder, HKMA has a role in the prioritisation of HKICL resources for system development. Such role would not have been available to HKMA if it was not a shareholder of HKICL, and priority might not have been given to market infrastructure such as the USD and Euro Clearing Systems and linkages with EuroClear and Clearstream.

These reasons are still valid today. While the introduction of a statutory oversight regime would help to enhance the safety and efficiency of the systems operated by HKICL, it may not fully address the needs set out above.

### **International practice**

HKMA has looked into the international practice regarding the issues of oversight role and shareholding in the payment system operator. Most central banks in other jurisdictions, including the US, the UK, France, Germany, Singapore and Australia, own and operate the high-value payment systems (equivalent of HK dollar RTGS system) due to the systemic importance of such systems. Most of these countries also have or will soon have some form of statutory backing on oversight such as the UK, France, Germany, Singapore and Australia.

For the less important clearing and settlement systems other than the RTGS systems, they are often operated by a clearing house. In most cases, there are central bank representatives to sit as directors and/or chairman on the management boards of such clearing house. Therefore, even though the central bank may not be a shareholder in the clearing house, it is closely involved in the management of the clearing house through representation on the board.

The analysis above points out that HKMA's stake in HKICL is in the public interest (particularly from the perspective of development of market infrastructure) and in line with international practices. There are thus good reasons for HKMA to retain its shareholding in HKICL, even with the introduction of a statutory oversight framework.

Yours sincerely,

(Edmond Lau)  
for Secretary for Financial Services and the Treasury