

For information

Legislative Council Panel on Financial Affairs

Octopus EPS add-value transactions incident

Purpose

This paper sets out the latest state of play in the multi-purpose stored value card (MPC) market from the regulatory and policy perspective, and updates the actions taken by the Hong Kong Monetary Authority (HKMA) following the independent auditor's review report on the Octopus EPS add-value transactions incident.

Regulatory regime

2. The current regulatory regime allows all licensed banks in Hong Kong to issue MPC and a non-banking institution to become a special-purpose deposit-taking company for issuing MPC. This regime provides a level playing field for existing and potential market players.

Promoting competition

3. To further promote competition in the MPC market, the HKMA encouraged Octopus Cards Limited (OCL) to voluntarily issue the *Code of Practice for Multi-purpose Stored Value Card Operation* in 2005. The Code, endorsed by the HKMA, requires that OCL should not adopt any measures unfairly limiting competition in the MPC market, and there should be no exclusive trading clause which prohibits the merchants from using other forms of stored-value payment system. The Code also requires that OCL should aim to share its technical platform with any other parties interested in card issuing and merchant acquiring business after taking into account security requirements and reasonable commercial considerations.

4. Triggered by the Octopus EPS add-value transactions incident, the HKMA

has reviewed the MPC market structure with a view to improving its competition environment. During the past few months, the HKMA has played a more active role as a facilitator and discussed with various parties, including OCL, other card scheme operators and card issuers, to explore possible ways of introducing competition to the MPC market. Various options have been examined based on their technical feasibility, commercial viability, impact on cardholders and operational risks to the system. Opening up the card-issuing business of Octopus is an option considered worth pursuing since this option offers choices to cardholders while not materially affecting the backbone system operation of Octopus.

5. Bearing in mind that Octopus cards are heavily used in public transport systems, any measure to introduce competition to the MPC market should not run the risk of jeopardising the smooth functioning of the current system. The HKMA would leave it as far as possible for the industry to come up with options to improve the competition environment of the MPC market.

Facing competition from other payment instruments

6. Though Octopus card currently dominates the MPC market, it has been facing competition from other retail payment instruments such as credit and debit cards in the retail sales market. The competition between credit cards and Octopus will become more intense as contactless credit cards have been launched in Hong Kong recently. In due course, we should see more competition in the contactless payment market given that contactless credit cards offer a similar level of convenience and speed of transactions to Octopus cards.

7. The HKMA will monitor closely the market development and the competition faced by Octopus. Taking into account the product development and technological advancement of the payment card industry in Hong Kong, the HKMA will, in consultation with relevant parties, consider further ways of enhancing competition in the MPC market, when appropriate.

Independent auditors' review commissioned under section 59 of the Banking Ordinance

8. The independent auditors have completed the review and issued a report to the HKMA. OCL has also submitted an action plan on the implementation of the recommendations. A copy of the report and the action plan has been submitted to the Financial Affairs Panel through the LegCo Secretariat. The HKMA is monitoring OCL's implementation of the recommendations and has required OCL to submit monthly progress report. So far, the implementation is on schedule and according to the timetable of the action plan.

9. The Advisor appointed under section 52(1)(B) of the Banking Ordinance will continue to monitor and advise OCL on the implementation of recommendations. His appointment will continue until the HKMA is satisfied that OCL has satisfactorily implemented all the recommendations of the report.

Refund arrangements for affected customers

10. So far over 98% of the identified failed Octopus EPS add-value transactions have been refunded. There are 284 failed transactions (with an aggregate value of around HK\$66,900) where banks are unable to contact the affected cardholders because the relevant accounts have been closed and attempted contacts with the customers using available information have failed.

Hong Kong Monetary Authority

November 2007