For discussion
on 7 April 2014

Legislative Council Panel on Financial Affairs

Proposed Regulatory Regime for
Stored Value Facilities and Retail Payment Systems in Hong Kong

PURPOSE

This paper briefs Members on the proposed regulatory regime for stored value facilities ("SVF") and retail payment systems ("RPS") in Hong Kong.

BACKGROUND

2. The global retail payment landscape has been developing rapidly. Technological advancements and increasing acceptance of new technologies by the public have led to the emergence of new forms of retail payment products and services, such as stored value payment cards, online stored value payment facilities, internet payment services and mobile payment services. In Hong Kong, there has been a growth in such products and services being offered to the public.

3. The current stored value card regime under the Banking Ordinance (Cap 155) ("BO") applies to device-based multipurpose stored value products, such as Octopus cards, while the Clearing and Settlement Systems Ordinance (Cap 584) ("CSSO") provides a legal framework for the Hong Kong Monetary Authority ("HKMA") to designate and oversee large-value clearing and settlement systems, such as the Real Time Gross Settlement systems. Nonetheless, some emerging stored value products and services, which store value on network-based account, mobile network account or computer server products and services, as well as payment systems related to retail activities, are currently not subject to specific regulation in Hong Kong.

4. The Administration sees the need to enhance the current regulatory framework to ensure the safety and soundness of SVF and RPS, and to maintain public confidence in payment systems, which in turn will help contribute to the stability and effective working of the financial systems in Hong Kong.

5. In the 2014-15 Budget, the Financial Secretary announced that the Administration seeks to introduce the relevant Bill into the Legislative Council in the next legislative session.

LEGISLATIVE AND REGULATORY FRAMEWORK

Legislative Approach

6. We propose to amend the CSSO to give effect to the proposed new regulatory framework for SVF and RPS, as the Ordinance already provides a comprehensive regulatory framework for large-value clearing and settlement systems. Such a comprehensive framework forms a solid foundation and can be readily extended to cover the regulation of RPS. The proposed arrangement also avoids duplicating the regulatory framework in different legislation, and is in line with the arrangements in many overseas jurisdictions, including the United Kingdom, European Union and the United States.

7. We also propose to migrate the existing multipurpose stored value card regime under the BO to the CSSO in future, and to expand it to cover the regulation of those SVF which are not device-based (see paragraph 8 below).

Regulatory Framework for SVF

8. The primary regulatory concern of SVF[1] stems from the need for protection of users' float[2] maintained by SVF issuers. To ensure issuers' soundness and proper protection and management of the float, we propose to introduce a mandatory licensing regime for SVF, so that no person shall issue SVF in Hong Kong unless it holds a licence granted by the HKMA. It will be a criminal offence to issue SVF without complying with the licensing requirements.

Coverage

9. The proposed SVF licensing regime will cover both device-based multipurpose stored value products (e.g. Octopus cards), and also non-device based multipurpose stored value facilities which store value on mobile network accounts or computer network-based accounts.

10. In line with the existing multipurpose stored value card regime under the BO, as well as the practices adopted by major overseas jurisdictions, single-purpose SVF should remain not being subject to specific regulation under the proposed regime. Single-purpose SVF are in essence bilateral contractual arrangements between service vendors and their respective users for advance payment for specific goods and/or services. Given its bilateral nature and magnitude, the degree of "moneyness" entailed by single-purpose SVF is minimal, posing insignificant risks to the payment and financial system of Hong Kong[3].

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[1] SVF can be classified into two broad categories according to the scope of their usage, namely multipurpose and single-purpose SVF. Multipurpose SVF can be used as a means of payment for goods and services provided by the issuer or third-party participating merchants at designated locations and points, while single-purpose SVF is used as a means of payment for goods and services provided by the issuer of the SVF only (e.g. prepaid coupons issued by cake shops, coffee shops, etc.).

[2] "Float" refers to the total sum of money paid by a user to an issuer, including any other sum of money received on the amount of the users, for storage on SVF.

[3] Nevertheless, there are laws in place to protect consumers in the course of general trade transactions that may involve single-purpose SVF. Examples of some existing consumer protection legislation in Hong Kong are the Sales of Goods Ordinance (Cap 26), the Trade Descriptions Ordinance (Cap 362), the Control of Exemption Clauses Ordinance (Cap 71), the Supply of Services (Implied Terms) Ordinance (Cap 457), and the Unconscionable Contracts Ordinance (Cap 458).

11. We propose that SVF which do not involve payment of money by users or have limited usage be excluded from the proposed SVF regulation. Similar to the existing multipurpose stored value card regime under the BO, the HKMA will retain the power to exempt an SVF from regulation. We propose that facilities which can only be used within, or within close proximity to the issuer's premises, or for the purchase of a limited range of goods or services from a limited group of goods or services providers would be considered for exemption[4]. In granting an exemption, the HKMA may attach conditions to require an exempt SVF issuer to do such things as the HKMA may specify so as to satisfy the HKMA that the exemption status of the issuer remains valid.

Licensing criteria

12. We propose that a set of licensing criteria for SVF be stipulated in the CSSO. The major proposed criteria include the following –

(a) ***Physical presence in Hong Kong***: A licensed SVF issuer must be a body corporate under Hong Kong law and have a registered office in Hong Kong. A foreign company which intends to issue SVF in Hong Kong will need to incorporate a company under Hong Kong law and apply to the HKMA for a licence. This requirement will allow the HKMA to exercise effective supervision of non-device based issuers where their systems and operations are not in Hong Kong and the services are provided through, for example, the internet.

(b) ***Principal business***: The principal business of the issuer must be the issuing of SVF to ensure that the principal resources of the licensee will only be used on its SVF business. Some SVF schemes may involve the provision of remittance or money changing service as ancillary or incidental services to its SVF issuing business. Such services may fall within the Money Services Operator ("MSO") licensing regime administered by the Customs and Excise Department ("C&ED") under the Anti-Money Laundering and Counter-Terrorist Financing

[4] Examples of these are petrol cards for refuelling or purchasing goods provided by a few other providers at a specified chain of petrol stations, and membership cards which can only be used to pay for goods and services offered by a few shops, clubs or organisations.

(Financial Institutions) Ordinance (Cap 615) ("AMLO"). To avoid any regulatory overlaps between SVF and MSO for the purposes of the AMLO, SVF licensees whose operations involve MSO businesses ancillary or incidental to its SVF business services will need to obtain an SVF licence from the HKMA and will not be required to obtain MSO licence from the C&ED.

(c) ***Financial strength***: An issuer must meet a minimum on-going capital requirement that the aggregate amount of its paid-up capital should not be less than HK$25 million. This is in line with the current arrangements for the multipurpose stored value card regime under the BO in which case the issuer is required to be authorized as a deposit-taking company and be subject to, among other things, a minimum level of share capital of HK$25 million.

(d) ***Management of float***: A licensed SVF issuer must have adequate risk management policies and procedures for the management of the float to ensure that there will be sufficient funds for the redemption of outstanding stored value. All licensed SVF issuers will be required to have in place protection arrangements that adequately protect the float, and to keep the float separate from the issuer's other funds[5].

(e) ***"Fit and proper" ownership and management, as well as prudential risk management requirements***: Controllers of SVF licensees must be fit and proper persons, and persons responsible for the management of the SVF business must possess appropriate knowledge and experiences. The licensee must have in place appropriate risk management processes and measures for its operation commensurate with the scale and complexity of the scheme.

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[5] The HKMA may approve the float protection arrangements on a case-by-case basis taking into account factors including financial strength; scale of business; risk management and internal control environment, etc. of each scheme. The HKMA will need to be satisfied that the types of investment which the licensee proposes to invest in are appropriate having regard to the financial strength, overall corporate governance, and risk management controls of the licensed SVF issuer.

13. In line with the existing multipurpose stored value card regime under the BO, licensed banks will be deemed to be licensed to issue SVF as their SVF business, if any, will be subject to regulatory requirements and on-going supervision by the HKMA on a consolidated basis. Nevertheless, they will still be required to comply with relevant requirements in the proposed regime, including float safeguarding and management, should they decide to continue, or embark on, SVF business.

Regulatory Regime for RPS

14. RPS generally covers credit card schemes, debit card schemes, large merchant acquirers, and payment gateways etc. Safe and efficient functioning of widely used RPS is essential to the smooth running of day-to-day economic activities. Similar to the existing regulatory approach for large value clearing and settlement systems under the CSSO, we propose to enlarge the existing designation regime under the CSSO to empower the HKMA to designate and oversee RPS if the proper functioning of which is material to the monetary and financial stability of Hong Kong or it is in the public interest to do so[6].

15. We are aware that SVF schemes normally require a clearing and settlement system to support their operation. Such a system may fall within the RPS definition. To avoid regulatory overlap, we do not intend to designate clearing and settlement system run by a SVF licensee to support its own SVF schemes. However, if the RPS operated by a SVF issuer supports SVF schemes run by other issuers, the HKMA may designate such RPS if it meets the designation criteria (paragraphs 16 to 17 below refer).

6 RPS which operates in Hong Kong or processes retail payment transactions denominated in Hong Kong dollar or other currencies of prudential concern to the HKMA would be eligible for consideration for designation under the proposed regime in the CSSO.

Designation criteria

16. We propose that the HKMA may designate a RPS if any disruptions to the RPS are likely to result in any one or more of the following –

(a) monetary or financial stability, or the functioning of Hong Kong as an international financial centre, being adversely affected;

(b) public confidence in payment systems or the financial system of Hong Kong being adversely affected; or

(c) day-to-day commercial activities in Hong Kong being adversely and materially affected.

17. In applying the above proposed designation criteria, the HKMA may take into account the estimated aggregate or average value of orders transferred, processed, cleared or settled through the system, the estimated number of orders transferred, processed, cleared or settled by the system, the estimated number of participants or users of the system, any direct or indirect interfaces to the large value payment systems, and any other considerations the HKMA thinks relevant.

Requirements on designated RPS

18. Under the proposed regime, designated RPS will be subject to oversight by the HKMA. To ensure their safety and robustness, they will be required to have in place operating rules to provide for the system to be operated in accordance with the requirements, including relevant default arrangements which are appropriate and adequate for the system. Designated RPS will also be subject to safety requirements which include, among other things, risk management and control procedures relating to the operation of the system; safety and integrity of information held within the system; soundness of the system including financial soundness; and efficiency requirements including cost of participation and reasonableness of criteria for admission as a participant in the system.

SUPERVISORY AND ENFORCEMENT POWERS

19. To enable the HKMA to perform various day-to-day supervision functions over SVF and RPS under the CSSO, we propose to incorporate relevant provisions of the BO as appropriate, so that the HKMA could conduct on-site examinations and off-site reviews, gather information, give directions, impose operating rules, make regulations, and issue guidelines and practical guidance, etc.

20. With reference to similar arrangements stipulated in the Securities and Futures Ordinance (Cap 571) and the AMLO, we propose that the HKMA be empowered to conduct investigation into SVF licensees and designated RPS when the HKMA has a reasonable cause to believe that an offence has been committed[7].

21. We propose that the existing sanctions under the BO and CSSO be used as a basis for sanctions under the proposed regime. In addition, we propose to empower the HKMA to impose a range of civil and supervisory sanctions[8], which are proportionate to the severity, circumstances, or duration of a breach, under the new regime in the CSSO.

22. To ensure that the exercise of the HKMA's powers is subject to checks and balances, we propose to expand the ambit of the existing Clearing and Settlement Systems Appeals Tribunal to cover appeals against HKMA's decision in relation to SVF and RPS. In addition, the

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7 The proposed powers include a power to direct investigator to conduct investigation, a power to compel provision of evidence from all persons relevant to the suspected contravention, a power to inspect records or documents taken in possession for the purpose of investigation, a power to require persons to render assistance in connection with the investigation, and a power to apply to a Magistrate for search warrants and seizures when necessary.

8 The proposed civil and supervisory sanctions include –
- (a) minor sanctions (such as caution, warning, reprimand, and order to take specified actions(s), etc.) and supervisory sanctions (such as temporary suspension, suspension or revocation of licence, or a combination of the above);
- (b) pecuniary penalty of not exceeding HK$10 million or three times the amount profit gained or loss avoided, whichever is higher, or
- (c) any combination of the above.

existing Process Review Committee will continue to review the processes and procedures adopted by the HKMA in applying oversight standards[9].

TRANSITIONAL ARRANGEMENTS

23. With respect to SVF, we propose to give a transitional period of 12 months to the existing SVF issuers to apply for SVF licences. Since large SVF issuers may require more time to migrate the existing user accounts to a new account structure and float protection arrangement after they are granted the licences, the HKMA will discuss with each SVF licensee, when the proposed regime starts to operate, the time it will require to ensure that adequate control measures are in place for the smooth and effective migration process.

PUBLIC CONSULTATION

24. The Administration conducted a three-month public consultation[10] in May 2013. The majority of respondents supported the proposed regulatory framework for SVF and RPS, as it enhances public confidence as well as the safety and soundness of the operation of SVF and RPS in Hong Kong. We will take on board many useful suggestions and comments after balancing relevant perspectives (in terms of product innovation, protection of users and maintaining monetary or financial stability of Hong Kong etc.) in contemplating the draft provisions in respect of regulatory coverage, licensing/designation criteria, and other requirements, as explained in the preceding paragraphs. We will issue a Consultation Conclusion to address these suggestions and comments in the coming months.

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[9] The Process Review Committee reviews and advises the HKMA on the adequacy of the HKMA's internal operational procedures and guidelines for applying the standards set under the CSSO to those designated systems in which the HKMA has a legal or beneficial interest. It seeks to ensure that the same set of standards is applied to all designated systems, whether or not the HKMA has an interest in them.

[10] The Consultation Paper has been uploaded to the homepages of the Financial Services and the Treasury Bureau (http://www.fstb.gov.hk/fsb/ppr/consult/doc/consult_emoney_e.pdf) and the HKMA (http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2013/20130522e3a1.pdf).

WAY FORWARD

25. The Administration is contemplating the Bill with a view to introducing it into the Legislative Council in the 2014-15 Legislative Year. Members are invited to note the proposed regulatory regime outlined in this paper.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
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