

立法會
Legislative Council

LC Paper No. CB(1)1284/03-04(01)

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**Bills Committee on
Clearing and Settlement Systems Bill**

Background Brief

Purpose

This paper sets out the background of the Clearing and Settlement Systems Bill (the Bill), and summarizes the views expressed by Members when the relevant proposed legislation was deliberated at the meeting of the Panel on Financial Affairs (FA Panel) on 5 May 2003.

Background

2. Under the Securities and Futures Ordinance (SFO) (Cap. 571), a clearing and settlement system operated by a company recognized as a clearing house providing services for the clearing and settlement of transactions in securities effected on a recognized stock market or for the clearing and settlement of transactions in futures contracts effected on a recognized futures market is subject to the regulation of the Securities and Futures Commission (SFC). There are however no express legal provisions for supervisory oversight of other important clearing and settlement systems in Hong Kong, as follows:

- (a) Hong Kong Dollar (HKD) Clearing House Automated Transfer System (CHATS);
- (b) US Dollar CHATS;
- (c) Euro CHATS;
- (d) Central Moneymarkets Unit;
- (e) Cheque Clearing; and
- (f) Cash settlement leg for Central Clearing And Settlement System (CCASS) in respect of equities and other securities listed and traded on the Hong Kong Stock Exchange.

3. At present, the systems set out in paragraph 2(a) to (f) above are subject to the de facto oversight of the Monetary Authority (MA) through the exercise of his general powers under sections 3A(1) and 5B of the Exchange Fund Ordinance (Cap. 66), his shareholdings in the Hong Kong Interbank Clearing Limited (HKICL) and contract agreements with system operators. However, there is no express statutory backing for the MA's oversight role.

4. Another problem of the existing supervisory framework is that there is no statutory provision providing for the finality of settlements effected through clearing and settlement systems operating in Hong Kong to protect settled transactions effected through such systems from insolvency laws. Statutory protection exists only in relation to settlement finality in the CCASS in respect of exchange-traded securities or futures contracts settled through the recognized clearing houses by SFC under Part III of SFO.

5. The above problems were identified by the International Monetary Fund (IMF) in its assessment of the financial system in Hong Kong. In its report dated 15 April 2003, IMF recommended that there should be explicit legislative provisions for the oversight of clearing and settlement systems and settlement finality in Hong Kong's important payment systems. To address these problems, the Administration introduced the Bill into the Legislative Council (LegCo) on 10 December 2003.

Objectives of the Bill

6. The objectives of the Bill are to provide express statutory backing:
- (a) for the oversight role of MA in relation to important clearing and settlement systems in Hong Kong, in line with concerns expressed by IMF; and
 - (b) for the finality of settlements effected through such systems, so as to facilitate the inclusion of HKD in the Continuous Linked Settlement (CLS) System^{Note}.

Note

The CLS System is a global clearing and settlement system for cross-border foreign exchange transactions. Many major international currencies, such as US dollar, Euro, Sterling, have already been admitted into the System. As in other jurisdictions, the CLS System requires, as a pre-condition for the admission of HKD, that the laws of Hong Kong provide for settlement finality as regards transactions within its system and within the underlying Real Time Gross Settlement System in Hong Kong.

Members' views expressed at Panel meeting

7. At the FA Panel meeting on 5 May 2003, some members have expressed the following views/concerns -

- (a) Whether consideration has been given to subject clearing and settlement systems to the oversight of SFC;
- (b) Whether there is comparable overseas legislation similar to the legislative proposal put forward by the Administration;
- (c) The Hong Kong Monetary Authority should consider disposing its shares in HKICL upon enactment of the Bill to avoid possible role conflict as both the regulator and operator of clearing and settlement systems; and
- (d) Whether there are international practices that could illustrate that overseas regulators derive their oversight powers from both legislation and shareholding in a clearing company.

8. An extract from the minutes of the FA Panel meeting held on 5 May 2003 (LC Paper No. CB(1)2017/02-03) is attached in **Appendix I**.

9. On paragraph 7(c) and (d) above, the Administration's written reply dated 26 May 2003 is attached in **Appendix II**.

Council Business Division 1
Legislative Council Secretariat
17 March 2004

LegCo Panel on Financial Affairs

**Extract from minutes of the meeting
held on 5 May 2003**

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V Briefing on the Clearing and Settlement Systems Bill
(LC Paper No. CB(1) 1554/02-03(05))

Briefing by the Administration

29. At the Chairman's invitation, the Executive Director (Monetary Management and Infrastructure) HKMA (ED/HKMA) briefed members on the details of the Clearing and Settlement Systems Bill (the Bill). He explained that at present while there was no express statutory backing for HKMA's oversight of important clearing and settlement systems (CSS) for funds or securities, it had been acting as a de facto overseer for CSS indirectly through provisions of the Exchange Fund Ordinance, the shareholdings in the Hong Kong Interbank Clearing Limited (HKICL) and contractual agreements with system operators. Moreover, there was no express statutory backing for settlement finality of CSS to provide protection for settled transactions through the system against unwinding from insolvency laws. The objectives of the Bill were to introduce statutory oversight of important CSS and to confer certainty of settlement finality for the systems.

Discussion with members

30. In response to Mr Henry WU's enquiry as to whether HKMA had considered subjecting CSS to oversight of SFC to facilitate the clearing and settlement of securities payments, ED/HKMA advised that as clearing and settlement of payments were mainly made through banks, it was a normal practice worldwide for central banks or banking regulators to take up the oversight role.

31. As to Mr Henry WU's enquiry on comparable overseas legislation similar to the current proposal, ED/HKMA said that apart from the payment system oversight legislation in Australia and Canada, some other advanced economies were considering similar legislative proposals. In the case of Singapore, it was proposed that the Monetary Authority of Singapore would be given the statutory power to oversee CCS. In UK, consideration was being made on conferring powers to organizations, such as the Office of Fair Trading,

to oversee CCS. He added that while in some jurisdictions, such as the United States (US) and the European Union, where the oversight role was currently taken up by competition authorities, these jurisdictions were considering the need for change in the light of the international trend to have central banks taking up the oversight role.

32. Mr SIN Chung-kai supported the proposal to provide express statutory backing for HKMA's oversight role in CCS. Nevertheless, he opined that HKMA should consider disposing of its shares of HKICL upon enactment of the Bill to avoid possible role conflict as both the regulator and operator of CCS. He also requested the Administration to provide information on the international practices in this area to illustrate whether overseas regulators derived their oversight power from both laws and shareholding in CCS concurrently.

33. In response, ED/HKMA said that as the shareholder of HKICL, HKMA had been participating in other areas of work to ensure efficient and safe operation of CCS. He was of the view that HKMA's shareholding in HKICL should not conflict with its oversight role as HKMA had been acting as a de facto overseer of CCS over the past years. Nevertheless, he undertook to consider Mr SIN Chung-kai's view and provide the requested information in due course.

(Post-meeting note: The Administration's response to members' request at paragraph 33 was issued to members vide LC Paper No. CB(1) 1790/02-03 on 27 May 2003.)

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26 May 2003

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Clerk to Financial Affairs Panel
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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