

For information on
26 March 2004

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

**Summary of Key Comments received before Gazettal
of the Bill and the Administration's Responses**

At the meeting on 18 March 2004, Members requested the Administration to provide a summary of views on the Clearing and Settlement Systems Bill expressed by interested parties before the Bill was finalized and gazetted in November last year. The Administration conducted a consultation with key stakeholders on draft provisions of the Bill in 2003. The summary table at the **Annex** sets out the key comments on the draft provisions and our responses. Members will note from the summary table that the concerns of the parties consulted have been addressed and reflected in the Bill as appropriate.

2. As regards comments received after the gazettal of the Bill and our corresponding responses, we have issued a similar paper for Members' information at the last meeting (vide LC Paper No. CB(1)1284/03-04(03)).

Hong Kong Monetary Authority
Financial Services and the Treasury Bureau
24 March 2004

Consultation on Clearing and Settlement Systems Bill 2003

Annex

Summary of Key Comments received before gazettal of the Bill and the Administration's Responses

<u>Subject/Clause</u>	<u>Organisation</u>	<u>Comments</u>	<u>Responses</u>
Definition of "book-entry securities"	The Law Society of Hong Kong ("LSHK")	The definition of "book-entry securities" may be defined along the lines of Schedule 1 of the Securities and Futures Ordinance ("SFO")	The definition of "securities" in Schedule 1 of the SFO is special and limited in order to suit the regulatory functions of the Securities and Futures Commission under the SFO. Since the intention of this Bill is to include all types of securities, the current definition is appropriate.
Definition of "netting" / Clause 2	CLS Bank International ("CLS")	The definition of "netting" should be expanded. The default arrangements of CLS system involve the netting of sums which are the direct result of the transfer orders as well as sums which are not the direct result of transfer orders.	The definition of "netting" has been amended along the lines suggested by CLS.
Definition of "participant" / Clause 2	The Law Society of Hong Kong ("LSHK")	The definition of "participant" should, for the avoidance of doubt, include the operator. In some systems where the operator is the central counterparty, funds will move from the payer's account to the operator's account, and from the operator's account to the recipient's account.	The definition of "participant" has been amended along the lines suggested by LSHK. Participant means a person who is a party to the arrangement by which the system is established. It therefore includes both system operator and settlement institution.
Definition of "clearing and settlement system" / Clause 2	Securities and Futures Commission ("SFC")	"Clearing and settlement system" does not include system that is a recognized clearing house for the purposes of section 37 of the SFO. This definition implies that the Bill will not apply to the entire operations of Central Clearing And Settlement System ("CCASS") because Hong Kong Securities Clearing Company Limited (the operator of CCASS) is currently a recognized clearing house under the SFO. Please confirm whether the Bill will apply to any of the CCASS operations.	Since SFC already has a power to designate entities which clear and settle securities transactions effected through the "recognized clearing houses", e.g. the CCASS, it is our intention that the proposed Clearing and Settlement Systems Bill should not overlap with the SFO to avoid any regulatory duplication with the SFC in the oversight of the CCASS. The Bill will concern itself with payment systems and systems for the clearing and settlement of securities, but not include such a system that is or of a recognised clearing house for the purpose of section 37 of the SFO.
Clause 3	CLS Bank International ("CLS")	The description of designated systems as being systems "in operation in Hong Kong" should be modified. CLS neither has premises nor staff in Hong Kong. Accordingly, as a matter of fact CLS could not be said to be in operation in Hong Kong as a result of having an account with the Hong Kong Monetary Authority alone.	The description of designated system in clause 3 has been amended to address the concern of CLS. CLS system will fall into the definition of clause 3(2)(b) under which it is a system that accepts for clearing and settlement transfer orders denominated in Hong Kong dollars.

Subject/Clause	Organisation	Comments	Responses
Revocation of designation / Clause 4	The Law Society of Hong Kong (“LSHK”)	<p>There should be a provision allowing for voluntary revocation by a system. And there should be a “grace period” given to a system, whether or not the revocation is voluntary or otherwise, during which it can wind down its operations in Hong Kong without unduly affecting participants, transactions or the public interest. The SFO has such a grace period in sections 28(2) and 43(2) relating to the withdrawal of recognition of a recognised exchange company and a recognised clearing house respectively.</p> <p>In addition, the period of 14 days under clause 4(2) may be too short, especially if the system affected wishes to appeal against such a decision and requires some time to prepare its case for appeal.</p>	<p>Voluntary revocation will not be allowed under the proposed oversight regime. The designation is a decision of the Monetary Authority (“MA”), the overseeing authority. There is an appeal mechanism in place if the designated system is aggrieved by the decision of the MA.</p> <p>The notice period of 14 days is considered reasonable. It should be noted that the system could still continue to operate although it is not a designated system.</p>
Clause 6	Hong Kong Exchanges Limited (“HKEx”)	Please clarify who has the obligation to ensure compliance with the requirements in relation to a designated system. Is it the person who establishes and operates the designated system?	This has been further clarified in the Bill that every system operator and settlement institution of a designated system should ensure compliance with the requirements.
Clause 7	Hong Kong Exchanges Limited (“HKEx”)	The operations of the system shall be conducted in a “safe” and “efficient” manner and clause 7 explains the references to the two terms. It would be useful to expand further the meaning of efficiency.	The meaning of efficiency has been further elaborated in clause 7(2). Efficiency refers to (a) the speed of the operations; (b) the overall cost to a participant; (c) reasonableness of criteria for admission as a participant; and (d) the absence of measures limiting competition.
Power to gather information / Clause 10	The Law Society of Hong Kong (“LSHK”)	Clause 10(1) gives the MA the power to request for any information relating to the system. We note that the application of clause 10(1) is restricted to information that will enable the MA to better carry out his functions under the Bill. However, an issue remains as to whether the power in clause 10(1) is appropriate in the context of international systems that operate, and have participants, in many jurisdictions. If the system or a participant is subject to the laws of another jurisdiction, duties of confidentiality in that jurisdiction may prevent the system from providing, or requiring the participant to provide, the information requested by the HKMA.	Clause 9 has been added to provide the MA with the power to exempt such overseas systems from the obligation imposed under Divisions 2 and 3 of Part II and from the obligations arising by virtue of the exercise of any power by MA conferred under those Divisions.
Power to gather information / Clause 10	The Law Society of Hong Kong (“LSHK”)	Is it the intention of the Bill that any failure to comply with such a request is an offence? The use of the word “request” implies that the system can elect not to provide the information.	It is the intention that failure to comply with such a request is an offence.

<u>Subject/Clause</u>	<u>Organisation</u>	<u>Comments</u>	<u>Responses</u>
Power to gather information / Clause 10	Hong Kong Exchanges Limited (“HKEx”)	Would it be more appropriate to impose obligations to the system operator (instead of the designated system) to provide the MA with information? Would this apply to the settlement institution?	Clause 10 has been amended to address the concern. The HKMA may request information from the system operator or settlement institution, as it thinks fit.
Power to gather information / Clause 10	Hong Kong Interbank Clearing Ltd (“HKICL”)	It should allow a reasonable period during which for information to be collected and provided.	Clause 10(2)(b) has been amended to include a reasonable period, along the line suggested by HKICL.
Clause 17	CLS Bank International (“CLS”)	<p>The description “any written law or rule of law of the law of insolvency”, has the effect of limiting the scope of the settlement finality to protection from insolvency law only. CLS firmly believes that settlements should be protected from “any written law or rule of law”.</p> <p>It is worth noting that the analogous legislation in Canada, Singapore and the New Zealand Bill give protection from all laws which may invalidate transfers without limitation to insolvency laws. CLS believes that the references to “of the law of insolvency” should be removed.</p>	<p>Clause 17 has been amended along the lines suggested by CLS and LSHK. The revised clause 17(2) states that:</p> <p><i>“Notwithstanding anything to the contrary in <u>any written law or rule of law</u>, a transfer or settlement to which this section applies shall not be liable –</i></p> <p>(a) <i>to be reversed, repaid or set aside; or</i></p> <p>(b) <i>to an order made by a court for the rectification or saty of such transfer or settlement.”</i></p>
	The Law Society of Hong Kong (“LSHK”)	It is suggested that settlement finality requires more than the disapplication of the laws of insolvency (although that is rightly its main focus), as there are other circumstances under which settlement may be “unwound” under Hong Kong law. For example, it is possible that a settlement or payment was made under duress or undue influence, a mistake of fact or was unconscionable, and a claim for restitution is made. If this claim is successful, this may result in an “unwinding” of the payment through the system.	
Clause 18	CLS Bank International (“CLS”)	The definition of “disposition of property” should be amended to encompass a pay-in by a participant. Thus, the words “held with a settlement institution” should be deleted from the definition of “disposition of property” since the local central bank to which a pay-in is made is not a settlement institution under the Bill. This amendment will allow a pay-in to be protected from Hong Kong insolvency law pursuant to clause 18(1)(b) of the Bill. This is so since clause 18(1)(b) gives protection to “any disposition of property in pursuance of a transfer order” which would include a pay-in into or out of the accounts of a central bank.	The definition of “disposition of property” has been amended to include pay-in to a clearing and settlement system which is utilised by the designated system to effect payments, along the lines suggested by CLS.

<u>Subject/Clause</u>	<u>Organisation</u>	<u>Comments</u>	<u>Responses</u>
		It is worth noting that the suggested approach is consistent with analogous legislation in Singapore, England and the provisions in the Reserve Bank of New Zealand Amendment Bill.	
Clause 18	Official Receiver (“OR”)	There is reference to appointment of a “liquidator, receiver, trustee in bankruptcy”. If the intention is to refer to a “receiver” appointed under the Bankruptcy Ordinance, then it is actually the Official Receiver who is appointed as receiver under section 12 of the Bankruptcy Ordinance. If the reference is to a “receiver” appointed either under a debenture or by the Court under Order 30, Rules of the High Court, Cap. 4, then please consider re-arranging the wording to “appointment of a liquidator, trustee in bankruptcy, receiver, receiver or manager or equivalent officer … ” since having “receiver” before “trustee in bankruptcy” may imply that it is the receiver appointed in bankruptcy.	Clause 18 has been amended to treat all insolvency office holders as officers equivalent to a liquidator or trustee in bankruptcy, along the lines suggested by OR.
Clause 22	CLS Bank International (“CLS”)	<p>In order for settlement finality on the CLS system to be adequately protected, the protection should cease on the earlier of the expiry of the day referred to in clause 22 and when CLS has actual notice of the events in clause 22.</p> <p>Due to the time difference between Hong Kong and New York (place of CLS system), it is possible that the day on which an order or resolution is made in Hong Kong (say, morning of 24th July) is in fact the previous day in New York (i.e. evening of 23rd July). It may be possible that “the expiry of the day ” in clause 22 could be construed to mean the expiry in New York of 23rd July, rather than the 24th, which we believe is not the intended meaning of that subsection.</p>	<p>Clause 22 has been amended to address the concern of CLS and IP. It is clarified that, where the designated system is established in a place other than Hong Kong, a reference to clause 22(1)(a) and to the expiry of a day on which an event mentioned in that paragraph occurred is a reference to the expiry of the same calendar day in that place as the calendar day in Hong Kong on which the event occurred.</p> <p>It is confirmed that the day refers to the day on which an order for bankruptcy or winding up is made or a resolution for voluntary winding up is passed.</p>

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	Insolvency Practitioners (“IP”)	The relevant “day” was to be the date of the relevant bankruptcy or winding up order, however, the date of such an order was different from the “commencement” of winding up which is taken to be the time of the presentation of the petition (except where a voluntary winding up resolution has been passed by the company). The Bill should be reviewed so as to ensure that it would achieve the policy intention on the extent of the protection (i.e., whether it was indeed intended to be up to the day of such an order allowing post-petition transfer orders be protected and not another reference time falling short of that day) and whether such reference to the “day” should be another reference day prior to the actual making of the relevant order (e.g., appointment of provisional liquidator).	
Preservation of rights / Clause 26	The Law Society of Hong Kong (“LSHK”)	Is this clause necessary given that clause 25 already provides that rights, interests, etc. of a person resulting from the underlying transaction is not affected?	Our policy intention is that the court’s power to grant a money compensation order (short of unwinding the transaction) should be preserved and hence clause 26, which confers a right on the insolvency holder to recover the gains of over-value/under-value transactions, should be retained. In this connection, we also have similar policy intention to enable relevant insolvency office holder to recover gains from an unfair preference. Clause 27 has reflected the above policy intention. (In subsequent discussions, CLS agreed to the amendments in clause 26 and the newly added Clause 27 and expressed no further comment on this issue.)
	CLS Bank International (“CLS”)	<p>Clause 25 already contains provisions, which preserve the rights of parties to the underlying transaction, including taking any action against the other party to the underlying transaction. In this regard, the provisions of clause 26 would at best appear to be repetitive of clause 25; at worst clause 26 breeds uncertainties and significantly weakens the settlement finality provided by other parts of the Bill.</p> <p>In any event, CLS believes that the scope of clause 25 is sufficiently broad to cover the policy concerns of clause 26. Accordingly, CLS proposes that clause 26 be deleted. Alternatively, the provisions of clause 25 and clause 26 could be merged: for example, the provisions of Section 25 could be expanded to specifically refer to the matters referred to in clauses 26(l)(a) and 26(l)(b).</p>	
	Insolvency Practitioners (“IP”)	IP prefer clause 26 to be retained.	

Subject/Clause	Organisation	Comments	Responses
Definition of “overvalue” and “undervalue” / Clause 26	Official Receiver (“OR”)	This section is similar to the transaction at undervalue or unfair preference sections in the Companies Ordinance and the Bankruptcy Ordinance. Do you wish to define “undervalue” or “overvalue”? Please note that “undervalue” is explained in section 49(3) of the Bankruptcy Ordinance.	Clause 26 has been amended to address the concern of OR. A transaction is entered into at an “undervalue” if it is entered into - (a) on terms that provide for the second participant or his principal to receive no consideration; or (b) for a consideration the value of which, in money or money’s worth, is significantly less than the value, in money or money’s worth, of the consideration provided by the second participant or his principal. The definition of “undervalue” is sufficient to cover both “overvalue” and undervalue” transactions.
	Standard Chartered Bank (“SCB”)	Please provide interpretation of “undervalue” and “overvalue” transactions.	
Clause 27	Official Receiver (“OR”)	<p>The relevant time is six months ending “with the commencement of the bankruptcy or winding up” of the second participant. Please note that under section 30 of the Bankruptcy Ordinance, commencement of the bankruptcy is to be the date of the bankruptcy order. Under section 184(2) of the Companies Ordinance, the commencement of the winding up by the Court is to be the date of the presentation of the petition. The period for the reckoning of time for transactions at undervalue or unfair preference in the Bankruptcy Ordinance is up to the date of presentation of the bankruptcy petition on which the debtor is adjudged bankrupt – section 51(1)(a) and for the Companies Ordinance is up to the commencement of its winding up – section 266(1).</p> <p>This will depend on the policy intention for the clause but please consider whether “the commencement of the bankruptcy” in clause 26 should be changed to the “presentation of the petition of the bankruptcy on which the debtor is adjudged bankrupt”. This may be particularly important because there is generally a few (about 2-3) months time lapse between the presentation of a bankruptcy petition up to the making of the bankruptcy order.</p>	Clause 27 has been amended to cover 6 months to the date of presentation of a petition for the bankruptcy or winding up or the passing of a resolution of a creditors’ voluntary winding up, in line with the suggestion of OR.
Penalty provisions / Clauses 39-42	HSBC	Given that the settlement institution has delegated the day-to-day operations to HKICL, the settlement institution should not be held liable in the first place for a contravention by HKICL as operator of the US dollar clearing system. Most of the offences are failure to comply with directions of the MA or to provide information to him, and these appear to be insignificant to warrant	Any oversight or supervisory regime will involve penalty provisions for offences, usually targeting at the individuals having the responsibility. This approach is similar to the approach adopted in other legislation of similar nature. In our designation notice, we will lay down clearly the responsibility of the

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		personal liability on directors.	settlement institution vis-à-vis the system operator.
Clause 54	Hong Kong Interbank Clearing Ltd (“HKICL”)	Only CHATS and Central Moneymarkets Unit will be deemed to have been designated. HKICL would like to know when HKICL’s other systems will be designated as it will be beneficial to all clearing members.	HKICL will be advised in the course of designation.
General	Hong Kong Association of Banks (“HKAB”)	Some provisions in the Bill empower the MA to make regulations and issue guidelines. HKAB would like to have the MA’s assurance that HKAB will be given the opportunity to comment on any such regulations or issues before they are made or issued.	Parties concerned will be consulted on any regulations or issues before decisions on such matters will be made by the MA.

- Ends -

Hong Kong Monetary Authority
Financial Services and the Treasury Bureau

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