

For discussion on
26 March 2004

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

Oversight and Institutional Arrangements

Background

At the first meeting of the Bills Committee on 18 March 2004, the following issues were raised by Members –

- (a) whether there will be proper “Chinese wall” arrangements within the Hong Kong Monetary Authority (“HKMA”) for the clear division of its oversight and system operations duties;
- (b) any checks and balances against the Monetary Authority’s powers for the oversight of clearing and settlement systems, in particular those operated by the HKMA itself;
- (c) appropriateness of exempting clearing and settlement systems operated by the HKMA^{Note} from the oversight requirements under Part 2 of the Bill;
- (d) possible conflict of interest arising from the Monetary Authority’s oversight of clearing and settlement systems in which the HKMA has an interest (e.g. the Hong Kong Interbank Clearing Limited (“HKICL”) which is 50% owned by the HKMA); and
- (e) any arrangement for coordination between the HKMA and the Securities and Futures Commission (“SFC”) over the supervisory oversight of designated systems and recognized clearing houses.

^{Note} These include the Hong Kong Dollar Clearing House Automated Transfer System (“HKD CHATS”) and the Central Moneymarkets Unit (“CMU”).

The Administration's Responses

International Practice

2. In the light of Members' concerns, we have reviewed the practices in a number of major overseas economies including Australia, Canada, the European Community ("EC"), the United Kingdom and the United States of America. As mentioned in another paper (LC Paper No. CB(1)1376/03-04(03)) submitted to the Bills Committee for consideration on 26 March 2004, some of these economies (notably Australia, Canada and the EC) have introduced a statutory oversight regime for important clearing and settlement systems like what we currently propose for Hong Kong. But regardless of whether such a regime exists, all the central banks in these five economies have responsibilities for the oversight function as well as being the operator/settlement institution/owner of certain key clearing and settlement systems. In the case of the three economies which have established a statutory oversight regime, the clearing and settlement systems of the central banks are also subject to statutory oversight requirements. To guard against any perceived or potential conflict of the central bank's roles as both a system overseer and system operator/settlement institution/owner of certain key clearing and settlement systems, all five economies have the oversight function and the system operations function undertaken by different and separated units within the central banks.

3. In view of the above findings, the Administration shares Members' concern that it might not be appropriate to exempt the systems operated by the HKMA (i.e. HKD CHATS and CMU) from the statutory oversight requirements under the Bill (see clause 54(3)), even though the HKMA would in any event exercise oversight of these systems to the same standard as that applicable to other important clearing and settlement systems. We are therefore prepared to remove that particular provision so that all designated systems are required by law to comply with the oversight standards and requirements.

Institutional Arrangements within HKMA

4. We also agree that there is a need to strengthen the institutional arrangements within the HKMA to avoid any perceived or potential conflict of roles as an overseer as well as a system operator. Upon enactment of the Bill, the HKMA intends to set up a new and separate Policy and Oversight Division

(through redeployment of existing HKMA resources) that is responsible for formulating payment systems oversight policy, developing the oversight guidelines and performing the day-to-day oversight functions. This new division will operate separately and independently from the existing Market Systems Division that is responsible for the operation of the HKMA-owned systems (including HKD CHATS and CMU) and also for the participation in HKICL to promote the development of financial market infrastructures. The HKMA will ensure that a proper Chinese wall is in place to segregate the operations of the two different units. The relevant operational procedures of the new division will also be subject to compliance checks by the Internal Auditor of the HKMA. These arrangements are in line with the arrangements adopted in other advanced economies.

HKMA's Shareholdings in HKICL

5. As regards the HKMA's shareholdings in HKICL, as previously explained to the Legislative Council Panel on Financial Affairs, the HKMA's ownership in HKICL is still desirable from two main perspectives. The first is to safeguard HKMA's interest as a major user of HKICL services and provider of key clearing and settlement system services to the financial community in Hong Kong. Secondly, this facilitates the HKMA's pursuance of its policy responsibility to promote the development of Hong Kong's financial market infrastructure, e.g. the US Dollar CHATS and the Euro CHATS. Also, as explained above, it is not uncommon for a central bank in other economies to own a strategically important payment system. We believe that the proposed strengthening of institutional arrangements within the HKMA mentioned above should help address the issue of potential role conflict.

Coordination between HKMA and SFC on regulatory functions

6. In the course of preparation of this Bill, the HKMA has been in close touch with the SFC. We believe that the Bill should not result in any regulatory overlap with the Securities and Futures Ordinance ("SFO"). If a clearing and settlement system is recognized by the SFC as a recognized clearing house, the Monetary Authority's power to designate would not apply to such a system to avoid regulatory overlap (see clause 3(2)).

7. In practice, the HKMA and the SFC will communicate with each other when they become aware of any emerging clearing and settlement system which falls within the remit of both ordinances or any change in the nature of activities of a clearing and settlement system. After the Bill is enacted, the HKMA will discuss further with the SFC with a view to articulating in some form the understanding on the coordination relating to overseeing clearing and settlement systems.

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