

For discussion on
26 March 2004

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

**Policy Issues and General Principles
(Parts 2, 4 and 5 of the Bill)**

Purpose

This paper sets out the policy intention and key parts of the Clearing and Settlement Systems Bill (the “Bill”) in relation to (a) the proposed designation and oversight regime (Part 2 of the Bill), (b) appeals mechanism (Part 4 of the Bill) and (c) offences (Part 5 of the Bill). An international comparison table on similar legislation is also attached at **Annex** for reference.

The proposed oversight regime (Part 2)

Policy intention

2. The policy intention of the proposed oversight regime is to provide explicit legislative provisions for the designation and oversight of important clearing and settlement systems in Hong Kong. This regime would enable the Monetary Authority (“MA”) to set requirements relating to the safety and efficiency of important clearing and settlement systems for funds and securities and give the MA the necessary powers to enforce such requirements. On the other hand, a designated system will be eligible to be considered by the MA for issuing to it a certificate of finality, and thereby enjoys finality of settlement under the Bill’s protection. The topic of finality of settlement will be further discussed in another paper for a separate meeting.

Designation approach

3. Under the proposed legislation, the MA may designate a clearing and settlement system for funds or securities as a “designated system”. A system may be designated and subject to oversight of the MA if the system is, or is likely to become, a system whose proper functioning is material to the monetary or financial stability of Hong Kong, or to the functioning of Hong Kong as an international financial centre (Clause 3(1) of the Bill).

4. To be eligible for consideration for designation, a clearing and settlement system must be one that –

- (a) is in operation in Hong Kong; or
- (b) accepts for clearing or settlement transfer orders denominated in Hong Kong dollars (Clause 3(2)).

5. For systems that are operated by the MA such as Hong Kong Dollar Clearing House Automated Transfer System and the Central Moneymarkets Unit, they are deemed to have been designated and a certificate of finality is deemed to have been issued to each of such systems (Clause 54 and Schedule 2).

Information collection for the purpose of designation

6. To ensure that there is sufficient information for the MA to determine whether a system should be designated, the MA, with reasonable grounds to believe that such system exists, may request information from the system operator or settlement institution of the system (Clause 51).

Avoidance of regulatory overlap

7. To avoid regulatory overlap with the Securities and Futures Commission under the Securities and Futures Ordinance, under clause 3(2) of the Bill, the power to designate will not apply to a clearing and settlement system that is, or is operated by a company recognised as, a clearing house for the purpose of section 37 of the Securities and Futures Ordinance (Cap. 571). This will for instance exempt the Hong Kong Securities Clearing Company Limited from designation under this Bill.

Revocation of designation

8. The MA may revoke the designation of a designated system that no longer meets the criteria for designation under paragraph 3 or 4 above. The MA is required to give the relevant designated system an opportunity to be heard and to make representations after notifying it of the MA's intention to revoke the designation (Clause 4).

Principal obligations of designated systems

9. Every designated system is required to have operating rules in place to ensure the system's safety (in relation to certainty of settlement, reliability and robustness of operation, proper security control and data integrity) and efficiency (in relation to the speed and efficiency of clearing and settlement operations, overall cost to participants, access by market

participants to the system and competition related issues), as well as compliance with the requirements specified in the Bill; and no change can be made to a designated system's operating rules without the prior approval in writing of the MA (Clauses 6 and 7).

Functions and Powers of the MA in respect of designated systems

10. It shall be the function of the MA both to monitor compliance of designation systems with the provisions of the oversight regime and to promote the safety and efficiency of their operations (Clause 8). To this end, it is proposed that the MA should have powers to exercise continuous oversight over a designated system including, inter alia –

- (a) the power to request information from a designated system for the better carrying out of his functions under the ordinance (Clause 10) and to give directions to a designated system for the purpose of bringing the system into compliance with the relevant requirements (Clause 11);
- (b) the power to amend a system's operating rules to bring them into compliance with the requirements in the Bill, after consultation with the Financial Secretary and the system operator or settlement institution (Clause 12); and
- (c) the power to make regulations in relation to the oversight of designated systems to ensure the safety, efficiency and financial soundness of such systems, as well as all other matters for the better carrying out of the object and purpose of the oversight regime (these regulations would be subsidiary legislation subject to the negative vetting of the legislature) (Clause 48).

11. It is also proposed that the MA should have the power to exempt from the oversight regime any system that is established in a place outside Hong Kong and is under the supervision of an authority exercising functions in that place similar to the functions of the MA under the proposed Ordinance (Clause 9). An instance we have in mind is the CLS Bank which is subject to oversight by the Federal Reserve Bank of New York.

12. The MA may also issue guidelines setting out the manner in which he proposes to exercise any power conferred or duty imposed on him, or to perform any function assigned to him (Clause 53).

International Precedents

13. Statutory oversight of clearing and settlement systems exists in some other jurisdictions. For example, (a) the Reserve Bank Act 1959 and Payment Systems (Regulation) Act 1998 in Australia give the Reserve Bank of Australia the responsibility for determining payments system policy and for designating payment systems; (b) the Payment Clearing and Settlement Act 1996 in Canada makes the Bank of Canada responsible for the oversight of clearing and settlement systems with a view to controlling systemic risk; (c) the Reserve Bank of New Zealand Amendment Act 2003 formalises the Reserve Bank of New Zealand's role in overseeing payment systems; and (d) Article 105(2) of the Treaty establishing European Community and Article 3 of the Statute of European System of Central Banks and European Central Bank ("ECB") put the responsibility on the ECB to ensure smooth operation of the settlement systems. Singapore and Switzerland are also in the process of formulating legislation with a comprehensive oversight regime. Comparison of different overseas statutory oversight frameworks is attached at the **Annex**.

Appeal mechanism (Part 4)

14. It is proposed that an independent tribunal known as the "Clearing and Settlement Systems Appeals Tribunal" should be established to hear appeals by any person who is aggrieved by a decision of the MA to designate a clearing and settlement system (Clause 3(1)), or to revoke a designation (Clause 4(1)), or to grant, revoke or suspend a certificate of finality in respect of a designated system (Clauses 14(1) and 15(1)). A person aggrieved may refer the decision to the Tribunal for review within 30 days after the decision is made by the MA or within such further time that the MA thinks fit (Clause 33). The Tribunal will consist of a Chairman who is appointed by the Chief Executive on the recommendation of the Chief Justice, and not fewer than two panel members who are appointed by the Financial Secretary with the Chairman's recommendation (Clause 32 to Clause 38 and Schedule 1).

Offences (Part 5)

15. To enable the MA to perform its oversight functions, it shall be an offence for a person not to comply with the various statutory requirements in this proposed ordinance, short of establishing the statutory defences provided in the respective provisions (Part 5). The table at the **Annex** for international comparison also includes references to the handling of offences.

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

International Comparison of Statutory Oversight Regimes for Clearing and Settlement Systems

Annex

Jurisdiction	Australia	Canada	European Community	Hong Kong	New Zealand	Singapore	Switzerland
Authority	The Reserve Bank of Australia (RBA)	The Bank of Canada (BOC)	European Central Bank (ECB)/National central banks	The Hong Kong Monetary Authority (HKMA)	The Reserve Bank of New Zealand (RBNZ)	Monetary Authority of Singapore (MAS)	The Swiss National Bank (SNB)
Legislation on Oversight	<p>(a) <u>Reserve Bank Act 1959</u> Payments System Board is given the responsibility for determining the RBA's payments system policy.</p> <p>(b) <u>Payment Systems (Regulation) Act 1998</u> The RBA is given the power to designate payment systems in the public interest for its regulation. Designated systems should observe rules and standards determined by the RBA.</p>	<p><u>Payment Clearing and Settlement Act 1996</u> The BOC is given the responsibility for the regulatory oversight of clearing and settlement systems.</p>	<p><u>Article 105 (2) of the Treaty establishing European Community</u></p> <p><u>Article 3 of the Statute of the European System of Central Banks and the European Central Bank</u></p>	<p><u>The Clearing and Settlement Systems Bill</u></p> <p>The MA may designate certain clearing and settlement systems for funds and securities to be subject to oversight by the MA.</p> <p>*The Bill is currently under draft.</p>	<p><u>The Reserve Bank of New Zealand Amendment Act 2003</u></p> <p>The purpose of new Part VB is to formalise the Reserve Bank's role in overseeing payment systems.</p>	<p><u>Payment System Oversight Act</u></p> <p>The Act is to provide MAS with a comprehensive framework for the oversight of payment systems in Singapore.</p> <p>*The enactment of the Act is still pending.</p>	<p><u>The Federal Law on the Swiss National Bank</u></p> <p>SNB is given the responsibility for overseeing clearing and settlement systems for funds and securities.</p> <p>*The Bill is currently under draft.</p>
Oversight Objectives	Controlling risk in financial system; promoting the efficiency of the payments system; promoting competition in the market for payment services	Controlling systemic risk	Promoting smooth operation of settlement systems	Maintaining monetary and financial stability; functioning of Hong Kong as an international financial centre	Promoting the maintenance of a sound and efficient financial system	Promoting financial stability and public confidence in payment systems	Protecting the stability of the financial system
Designation of systems for oversight	The RBA has general oversight power under the Reserve Bank Act 1959. Furthermore, the RBA may rely on the Payment Systems (Regulation) Act 1998 to designate a particular payment system if it considers that it is in the public interest to do so.	The BOC may designate any eligible clearing and settlement system that may pose systemic risk. Eligible systems are further defined in BOC's guideline.	Not applicable	The HKMA will be given power to designate payment systems material to the monetary or financial stability of Hong Kong or to the functioning of Hong Kong as an international financial centre.	Not applicable	Not applicable	The SNB may determine a system to comply with the minimum requirements if the system is important to the stability of the financial system.
Authority to collect information	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Authority to issue standards, guidelines, directions	Yes	Yes	Yes	Yes	No	Yes	Yes
Offences	Criminal code applies to non-compliance in Payment Systems (Regulation) Act 1998.	Contravention of provisions of the Act is guilty of an offence and is liable to fine or imprisonment.	Subject to legal instruments available to ECB and national central banks.	Contravention of certain provisions of the legislation is guilty of an offence and is liable to fine or imprisonment.	Fine or imprisonment for offences in failing to supply information and proper disclosure of information.	Not yet available, but there is intention for the MAS to assume control of and carry on the business of the designated system if the operation of the designated system is likely to be detrimental to the participants.	Not yet available