

For discussion  
on 23 April 2004

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

**Process Review Committee on  
Hong Kong Monetary Authority related  
Clearing and Settlement Systems**

**Background**

At the second meeting of the Bills Committee on 26 March 2004, some Members expressed concern that there might be a role conflict when the Hong Kong Monetary Authority (HKMA) conducts oversight of such clearing and settlement systems in which the HKMA has a direct or indirect interest (hereafter referred to as “HKMA systems”<sup>Note</sup>). The Administration was invited to consider whether it might be desirable to set up an independent body to review whether there is any discrepancy in the HKMA’s oversight of the HKMA systems as compared to other systems, in terms of procedural fairness and adherence to due process.

**HKMA’s commitment to excellence in financial infrastructure and to uphold international standards**

2. At present, in the absence of a statutory oversight framework, the HKMA is already the de facto overseer of the important clearing and settlement systems in Hong Kong. The HKMA also oversees the governance and operation of the HKICL in its capacity as an HKICL shareholder. This is because safe and efficient clearing and settlement systems are important to the monetary and financial stability of Hong Kong and to Hong Kong’s status as an international financial centre. At the same

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<sup>Note</sup> The HKMA is the owner/operator of the Hong Kong Dollar Clearing House Automated Transfer System (HKD CHATS) and the Central Moneymarkets Unit. The HKMA also has a 50% shareholding in the Hong Kong Interbank Clearing Limited (HKICL), which is the system operator for some clearing and settlement systems in Hong Kong. These are referred to as “HKMA systems”.

time, the HKMA participates actively in the G-10 Committee on Payment and Settlement Systems, which is the main body setting international standards. The HKD CHATS, with its state-of-the-art design and functionality, is the first Real Time Gross Settlement system in the Asia Pacific when the HKMA introduced it in 1996. Also the first “Payment versus Payment” arrangement for foreign exchange transactions in the region was made in Hong Kong in September 2000. The HKMA systems have maintained a 100% up-time since December 1996. In the 2003 Financial Sector Assessment Program, the International Monetary Fund (IMF) commented that “the payment systems in the HKSAR are efficient, and fully support the operations of the wholesale markets for money, foreign exchange, and securities trading” and that “the HKSAR’s securities operations are efficiently supported by the settlement system”.

3. Notwithstanding the high standards of the clearing and settlement systems in Hong Kong, the IMF suggested that it would be desirable for Hong Kong to have a statutory oversight regime for clearing and settlement systems. The suggestion from the IMF has been an important driving force for this current exercise of establishing formally a statutory oversight regime.

### **Proposal to establish a Process Review Committee on HKMA Systems**

4. Apart from the HKMA’s own commitment and periodic reviews by the IMF, there will also be other checks and balances on the exercise of the HKMA’s oversight powers under the statutory oversight regime. Under the appeals mechanism in the Clearing and Settlement Systems Bill (“CSS Bill”), an aggrieved system operator or settlement institution can appeal against the Monetary Authority’s decisions. The decisions of the Monetary Authority will then be subject to an impartial review by the Clearing and Settlement Systems Appeals Tribunal.

5. Most of the participants in the HKMA systems are also participants in the non-HKMA systems. Market participants could therefore easily identify and point out any discrepancy in the oversight rules and standards imposed by the HKMA on HKMA systems as against non-HKMA systems. Moreover, the banks through the Hong Kong Association of Banks (HKAB) have a 50% stake in the HKICL. They also take part in the governance of the HKICL and would not hesitate to ensure that the same standards are applied by the HKMA in its oversight activities so that there

would be procedural fairness and consistency for all clearing and settlement systems under oversight. The relevant clearing house rules, i.e. operating rules of clearing and settlement systems, are all subject to approval by the HKAB. Should there be any preferential rules for HKMA systems, they would be readily noticeable and rectified before approval.

6. Notwithstanding the excellent record of the HKMA in promulgating international standards and the various checks and balances mentioned above, the Administration accepts that, once a formal statutory oversight regime to be administrated by the HKMA is established, there is a case for addressing any residual concern, whether real or perceived, on ensuring impartiality and level playing field for the HKMA systems and other systems. In this connection, the Administration proposes to set up a committee, to be appointed by the Chief Executive under the Interpretation and General Clauses Ordinance (Cap.1), to review whether there are any discrepancies in the HKMA's oversight of the HKMA systems as compared to other systems, on –

- (a) the setting of standards and conditions (i.e. procedural fairness regarding whether those for the HKMA systems are at lower levels); and
- (b) the adherence to the due process in enforcing compliance with such standards and conditions (i.e. whether the HKMA takes a “softer” stance in policing its own systems.)

It is proposed that both the chairman and members of the committee will be independent persons appointed by the Chief Executive. The committee will consider the above issues and prepare annual reports to the Financial Secretary. It is envisaged that the Financial Secretary shall cause these reports to be published in the interest of transparency and accountability.

7. The committee will be established by the Chief Executive under Cap.1 and thus have proper legal basis. In light of our experience with the Process Review Panel set up for the Securities and Futures Commission by the Chief Executive, we consider it appropriate to have the committee set up on an administrative basis. This is also in line with the international practice (paragraph 8 below).

## **International practices**

8. On Members' request, we have checked with several major jurisdictions on their oversight practice, including Australia, Canada, the European Union and the United Kingdom. As regards oversight of the oversight teams' activities, all four central banks have internal committees to which the oversight teams would be accountable. Some of these internal committees have independent members from outside the central banks. The proposed committee in our case will comprise all independent members. Like the HKMA, these central banks have internal division of responsibilities to segregate oversight from operational duties. All four jurisdictions institute a "Chinese wall" between the operational and oversight teams in that there is clear segregation of duties between the two teams to prevent any conflict of interest. The two sides of the house nevertheless have regular contacts over issues that are of mutual interest to both areas, like the policy implications of operational developments and vice versa.

## **Way forward**

9. Subject to Members' comments on the proposal, the Administration plans to proceed to introduce Committee Stage Amendments in order to allow the passing of confidential information regarding the HKMA's oversight activities to this Process Review Committee for HKMA systems.

Hong Kong Monetary Authority  
Financial Services and the Treasury Bureau  
22 April 2004