

For discussion
on 26 April 2004

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

Extra-territorial Effect

Background

At the second meeting of the Bills Committee on 26 March 2004, the Administration was invited to consider whether clearing and settlement systems based and/or operating outside Hong Kong but accepting for clearing or settlement transfer orders denominated in Hong Kong dollars were covered by the Clearing and Settlement Systems Bill (“the Bill”). In this connection, the Administration was invited to –

- (a) clarify whether the Bill (e.g. clause 51 (power of the Monetary Authority to require information to be given) has extra-territorial effect and if so, consider setting out the relevant arrangements in the Bill; and
- (b) provide information on the practices adopted by other jurisdictions in this regard.

The Administration’s Response

Need for extra-territorial application

2. In general, the Bill has extra-territorial application only to the extent that the Monetary Authority may for the purposes of this proposed legislation designate a clearing and settlement system if it accepts for clearing or settlement transfer orders denominated in Hong Kong dollars, albeit the system is in operation outside Hong Kong (see clause 3(1) and (2)(b)). Specifically, the purpose of clause 51 is to seek information on a presumed clearing and settlement system so as to enable the Monetary Authority to form a view on designation. The general provisions under the Bill apply to systems both in Hong Kong and overseas, as long as they are eligible for designation or are designated. Such extra-territorial application is necessary in order to achieve the objective of safeguarding the monetary and financial stability of Hong Kong and its functioning as an international financial centre.

3. The corollary of designating an overseas system is that the relevant provisions in the Bill will necessarily have extra-territorial

application. Only through an extra-territorial application of the Bill can the Monetary Authority ensure that the safety and efficiency of a designated system, regardless of where it operates, is up to the standards that the Monetary Authority requires. As regards settlement finality, extra-territorial application is also necessary in order to allow Hong Kong dollar denominated transfer orders settled outside Hong Kong to enjoy protection from possible unwinding due to the insolvency or other laws of Hong Kong.

4. Such oversight of overseas systems under the Bill is also necessary to ensure a level playing field between local and overseas systems. This can avoid “regulatory arbitrage” in the sense that some systems might otherwise choose to operate outside Hong Kong to get out of the oversight regime.

Local precedent

5. Members may wish to note that the extra-territorial application of the Bill is not an unique arrangement. Reference can be drawn from the Securities and Futures Ordinance (SFO) in relation to the authorization of automated trading services (ATS). Under section 95 of the SFO, the Securities and Futures Commission (SFC) can authorize a person to provide ATS. The SFO also empowers the SFC to impose conditions and make rules in respect of an authorized ATS provider. These powers apply to ATS actively marketed, whether in Hong Kong or elsewhere, to persons in Hong Kong.

International practices

6. On Members’ request, we have checked with several major jurisdictions on their extra-territorial application of the relevant legislation. We note that there is extra-territorial application in respect of settlement finality under the Payment and Settlement Systems (Finality and Netting) Act 2002 in Singapore. Other jurisdictions do not have similar arrangements due to differences in their oversight regimes. For the oversight of overseas clearing and settlement systems such as the Continuous Linked Settlement System (CLS), these jurisdictions choose to rely on co-operative oversight with the relevant home supervisor, i.e. the Federal Reserve Bank of New York in the case of CLS. It should be noted that the trend of establishing a statutory oversight regime on clearing and settlement systems has only started to evolve in recent years.

Way forward

7. Paragraphs 2 to 4 above reflect our policy intent as to the extra-territorial effect of the Bill. We will consider making the extra-territorial effect of the Bill more explicit by introducing Committee Stage

Amendments to the offence provisions to make it clear that these apply to persons both in and outside Hong Kong.

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