

For discussion
on 29 April 2004

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

**Part 3 of the Clearing and Settlement Systems Bill
Clause-by-clause examination**

The Administration has proposed a number of Committee Stage Amendments to Part 3 of the Bill in the light of comments from various parties concerned. Please refer to the **Annex** for a marked-up version of Part 3 with footnotes explaining the reasons for the amendments. The Chinese version of the Committee Stage Amendments will be provided for Members' consideration at the next meeting.

2. Similar to the case of Parts 1 and 2 of the Bill, we are considering some residual comments from the market and the Legislative Council Assistant Legal Adviser. We will revert to Members on the need for any further amendments as soon as possible.

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

Clearing and Settlement Systems Bill
Proposed Committee Stage Amendments
(Marked-up version)

Part 3, Divisions 1 to 3 (Clauses 13 to 22)
Draft 1 (issued: 29 April 2004)

PART 3

FINALITY OF TRANSACTIONS AND PROCEEDINGS

Division 1 – Interpretation

13. Interpretation

In this Part, a reference to the law of insolvency shall be construed as a reference to –

- (a) the Bankruptcy Ordinance (Cap. 6);
- (b) Parts V, VI and X of the Companies Ordinance (Cap. 32); and
- (c) any other written law or rule of law whether of Hong Kong or a place outside Hong Kong which is concerned with or in any way related to the bankruptcy, winding up or insolvency of a person.

Division 2 – Certificate of finality

14. Monetary Authority may issue certificate of finality

(1) Where a clearing and settlement system has been designated under Part 2, the Monetary Authority shall determine in accordance with subsection (2) whether the following criteria are met as regards that system, namely –

- (a) ultimate settlement of transfer orders is effected within the system itself; and

- (b) there is compliance with the requirements stipulated in section 6(1).
- (2) In making a determination under subsection (1) the Monetary Authority –
 - (a) shall have regard to such information relating to the system as may be submitted to him by the system operator for the purposes of this section; and
 - (b) may in addition have regard to such other information in his possession relating to the system as he considers relevant,

but the Monetary Authority shall not be under any obligation to undertake any enquiries for the purpose of making the determination.

(3) If the Monetary Authority determines that the criteria specified in subsection (1) have been met as regards a designated system, he shall issue in respect of the system a certificate certifying to that effect ("certificate of finality") and specifying a date and time as from which the certificate shall have effect¹.

(4) If the Monetary Authority finds himself unable to make a determination in the terms mentioned in subsection (3) as regards a designated system, he shall inform the system operator in writing accordingly giving particulars of the respect in which any of the criteria specified in subsection (1) have not been met or of the further information he requires in order to make a determination in relation to such criteria.

(5) Except for the period of any suspension under section 15(1), a certificate of finality in respect of a designated system remains in effect until it is revoked or until the designation of the system for the purposes of this Ordinance has been revoked.

(6) Except as otherwise provided, the following provisions of this Part apply to and in relation to any designated system in respect of which a certificate of finality is in effect; and in Divisions 3, 4 and 5 of this Part, a reference to a designated system is a reference to such a designated system.

¹ This amendment is proposed to a response to a related comment from the Legislative Council Assistant Legal Adviser (ALA) to avoid uncertainty as to the date and time from which a certificate of finality should have effect. Refer also to footnote 3.

(7) The Monetary Authority shall publish in the Gazette notice of any certificate of finality issued under this section.²

15. Suspension or revocation of certificate of finality

(1) The Monetary Authority may at any time by notice in writing, with effect as from a date and time specified in the notice.³ suspend or revoke a certificate of finality in respect of a designated system if he is of the opinion that, as regards that system –

- (a) any one or more of the criteria specified in section 14(1)(a) or (b) are no longer met; or
- (b) there has been any contravention of section 5(2), 6(3), 10, 11, 12, 43 or 52(4).

(2) Before suspending or revoking a certificate of finality under this section the Monetary Authority shall –

- (a) notify in writing the system operator and settlement institution of his intention to suspend or revoke the certificate of finality and the grounds on which the suspension or revocation is to be made; and
- (b) allow such period as is specified in the notice, being a period of not less than 14 days, within which the system operator or settlement institution may be heard or may make representations as to why the certificate of finality should not be suspended or revoked.

(3) The Monetary Authority shall publish in the Gazette notice of any suspension or revocation of a certificate of finality effected under this section.⁴

² This amendment is proposed in response to the comment from the ALA that the Monetary Authority should publish notice of the issuance, suspension and revocation of a certificate of finality. The gazettal arrangement will help enhance transparency of the Monetary Authority's decision in this regard.

³ This amendment is proposed in response to the comment from the ALA that there is a need to provide expressly the time when the suspension or revocation takes effect.

⁴ Refer to footnote 2.

Division 3 – Finality of transactions and proceedings within designated systems

16. Scope of modification of law of insolvency under this Division

- (1) The **general**⁵ law of insolvency shall have effect in relation to –
 - (a) transfer orders effected through a designated system;
 - (b) action taken under the operating rules of a designated system with respect to such orders; and
 - (c) collateral security,

subject to the provisions of this Division.

(2) This Division shall apply in relation to bankruptcy and winding up proceedings in respect of a participant, but shall not apply in relation to bankruptcy and winding up proceedings in respect of any person who is not a participant.

(3) For the avoidance of doubt, notwithstanding that rights or liabilities arising from transfer orders as mentioned in subsection (1)(a) are or may be dealt with in bankruptcy and winding up proceedings, this Division shall not apply to such proceedings if they are in respect of any person who is not a participant.

17. Transfers and settlements within designated systems are final

(1) This section applies to any transfer or settlement of the following description that is effected through a designated system the operating rules of which provide that such a transfer or settlement is final and irrevocable –

- (a) a transfer of funds into or out of an account of a participant;
- (b) a settlement of a payment obligation; or

⁵ This amendment is proposed in response to a drafting comment from the ALA to ensure consistency throughout the Bill.

- (c) a settlement of an obligation for the transfer of book-entry securities, or the transfer of such securities.

(2) Notwithstanding anything to the contrary in any written law or rule of law, a transfer or settlement to which this section applies shall not be liable –

- (a) to be reversed, repaid or set aside; or
- (b) to an order made by a court for the rectification or stay of such transfer or settlement.

18. Proceedings of designated systems take precedence over law of insolvency

(1) None of the following shall be regarded as to any extent invalid on the ground of inconsistency with the law of insolvency regarding distribution of the assets of a person on bankruptcy or winding up, or on the appointment of a liquidator, trustee in bankruptcy or equivalent officer over any of the assets of a person –

- (a) a transfer order;
- (b) any disposition of property in pursuance of a transfer order;
- (c) the default arrangements of a designated system;
- (d) the operating rules of a designated system as to the settlement of transfer orders not dealt with under its default arrangements; or
- (e) a contract for the purpose of realizing collateral security in connection with participation in a designated system otherwise than pursuant to its default arrangements.

(2) The powers of a relevant insolvency office holder in his capacity as such and the powers of a court under the law of insolvency, shall not be exercised in such a way as to prevent or interfere with –

- (a) the settlement of a transfer order in accordance with the operating rules of a designated system not dealt with under its default arrangements;

- (b) any action taken under the default arrangements of a designated system; or
- (c) any action taken to realize collateral security in connection with participation in a designated system otherwise than pursuant to its default arrangements.

(3) A debt or other liability arising out of a transfer order which is the subject of action taken under default arrangements may not be proved in a bankruptcy or winding up until the completion of the action taken under default arrangements.

(4) A debt or other liability which by virtue of subsection (3) may not be proved shall not be taken into account for the purposes of any set-off until the completion of the action taken under default arrangements.

19. Abrogation of statutory provisions relating to disclaimer of property, restriction on dispositions of property, etc.

Without prejudice to the generality of section 18 –

- (a) section 59 of the Bankruptcy Ordinance (Cap. 6) and section 268 of the Companies Ordinance (Cap. 32) shall not apply to a transfer order; and
- (b) section 42 of the Bankruptcy Ordinance (Cap. 6) and section 182 of the Companies Ordinance (Cap. 32) shall not apply to a transfer order or any disposition of property in pursuance of such an order.

20. Abrogation of statutory powers relating to adjustment of prior transactions

Without prejudice to the generality of section 18, no order shall be made by a court under any of the following provisions in ~~relation to~~respect of⁶ a transfer order or any disposition of property in pursuance of such an order –

- (a) section 49 or 50 of the Bankruptcy Ordinance (Cap. 6);
- (b) section 266 of the Companies Ordinance (Cap. 32);
- (c) section 60 of the Conveyancing and Property Ordinance (Cap. 219).

21. Net sum payable on completion of default arrangements provable in insolvency proceedings

(1) This section shall apply with respect to any net sum owed by or to a defaulting participant on the completion of the action taken under default arrangements.

(2) Where a court has made an order for bankruptcy or winding up of a participant or a resolution for the voluntary winding up of a participant has been passed, the net sum referred to in subsection (1) shall be –

- (a) provable in the bankruptcy or winding up or, as the case may be, payable to the relevant insolvency office holder; and
- (b) taken into account, where appropriate, under section 35 of the Bankruptcy Ordinance (Cap. 6) or that section as applied in the case of a winding-up order under the Companies Ordinance (Cap. 32).

(3) Subsection (2) applies notwithstanding section 34 or 35 of the Bankruptcy Ordinance (Cap. 6) and section 264 of the Companies Ordinance (Cap. 32).

⁶ This amendment is proposed in response to a drafting comment from the market to make clearer that the provision will not cover an underlying transaction of a transfer order.

22. Transfer orders entered into designated system after insolvency not affected

(1) This Division shall not apply in relation to any transfer order given by a participant which is entered into a designated system after the occurrence of either of the following, whichever first occurs –

- (a) the expiry of the day on which –
 - (i) a court has made an order for bankruptcy or winding up in respect of the participant; or
 - (ii) a resolution for the voluntary winding up of the participant has been passed; or
- (b) the receipt by the system operator of notice of the making of an order or the passing of a resolution as is mentioned in paragraph (a).

(2) Where the designated system is established in a place other than Hong Kong, being a place in which local time is behind local time in Hong Kong, reference in subsection (1)(a) 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.

(3) For the purposes of subsection (1)(b), a system operator shall be taken to have received notice of an event mentioned in subsection (1)(a) if he deliberately failed to make enquiries as to that matter in circumstances in which a reasonable and honest person would have done so.

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Part 3, Divisions 4 and 5 (Clauses 23 to 30)
Draft 1 (issued: 29 April 2004)

PART 3

FINALITY OF TRANSACTIONS AND PROCEEDINGS

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Division 4 – Netting of obligations of insolvent participants

23. Netting may be effected

(1) Where a court has made an order for bankruptcy or the winding up of a participant in a designated system, or a resolution for the voluntary winding up of such participant has been passed, then, notwithstanding any provision of the law of insolvency, the system operator of the designated system may effect the netting of all obligations owed to or by the participant incurred up to the time of the occurrence that applies for the purposes of section 22(1).

(2) Where any netting has been effected as provided in subsection (1), then –

(a) the obligations that are netted shall be disregarded in the bankruptcy or winding up proceedings; and

(b) any net obligation owed to or by the participant that has not been discharged –

(i) is payable to the participant and may be recovered for the benefit of his creditors; or

(ii) is provable in the bankruptcy or winding up,

as the case may be.

(3) A netting effected as provided in subsection (1) and any payment made by a participant as provided in subsection (2) shall not be voidable in the bankruptcy or winding up proceedings.

Division 5 – Miscellaneous

24. Law of insolvency in other jurisdictions

Notwithstanding any law to the contrary, a court shall not recognize or give effect to –

- (a) an order of a court exercising jurisdiction under the law of insolvency in a place outside Hong Kong; or
- (b) an act of a person appointed in a place outside Hong Kong to perform a function under the law of insolvency there,

in so far as the making of the order or doing of the act would be prohibited under this Part for a court in Hong Kong or a relevant insolvency office holder.

25. Preservation of rights, etc. in underlying transactions

(1) Except to the extent that it expressly provides, this Part shall not operate to limit, restrict or otherwise affect –

- (a) any right, title, interest, privilege, obligation or liability of a person resulting from the underlying transaction in respect of a transfer order which has been entered into a designated system; or
- (b) any investigation, legal proceedings or remedy in respect of any such right, title, interest, privilege, obligation or liability.

(2) Nothing in subsection (1) shall be construed to require –

- (a) the unwinding of any netting effected by the system operator of a designated system, whether pursuant to its default arrangements or otherwise;
- (b) the revocation of any transfer order given by a participant which is entered into a designated system; or
- (c) the reversal of a payment or settlement made under the operating rules of a designated system.

26. Right of relevant insolvency office holder to recover gain from transaction at undervalue between 2 participants

(1) This section applies to any transaction between 2 participants in a designated system that –

- (a) is entered into at an undervalue to the gain of one of the participants (“first participant”); and
- (b) was entered into at any time during the period of 6 months ending with –
 - (i) the presentation of a petition for the bankruptcy or winding up of the other participant (“second participant”) or his principal; or
 - (ii) the passing of a resolution of a creditors’ voluntary winding up of the second participant or his principal.

(2) A relevant insolvency office holder acting in respect of the second participant to a transaction to which this section applies or his principal is hereby entitled to recover from the first participant to the transaction an amount equivalent to the gain made from the transaction.

(3) For the purposes of this section, 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.

(4) At the request of a system operator or settlement institution of a designated system the Monetary Authority may, by notice published in the Gazette, exempt the system operator or settlement institution from the application of this section; and where such an exemption is in effect this section shall not apply in respect of any transaction entered into by the system operator or settlement institution (as the case may be) as first participant in his capacity as such system operator or settlement institution.

(5) For the avoidance of doubt, nothing in this section has the effect of derogating from section 18(2) or 20.

27. Right of relevant insolvency office holder to recover transfer between 2 participants giving unfair preference

(1) This section applies to any transfer of funds or securities from one participant in a designated system to another, being –

- (a) a transfer to which section 17 applies (other than a transfer that forms part of a transaction to which section 26 applies);
- (b) a transfer by which the participant who is the recipient of the transfer ("first participant") is given an unfair preference by the participant making the transfer ("second participant") or by the principal of the second participant acting through the second participant; and
- (c) a transfer that is effected at any time during the period of 6 months ending with –
 - (i) the presentation of a petition for the bankruptcy or winding up of the second participant or his principal; or

- (ii) the passing of a resolution of a creditors' voluntary winding up of the second participant or his principal.

(2) A relevant insolvency office holder acting in respect of the second participant to a transfer to which this section applies or his principal is hereby entitled to recover from the first participant to the transfer an amount equivalent to the value of the transfer.

(3) For the purposes of this section, a transfer is a transfer as described in subsection (1)(b) if –

- (a) the first participant is a creditor of, or is a surety or guarantor for any debts or liabilities of, the second participant or his principal;
- (b) the transfer has the effect of putting the first participant into a position which, in the event of the bankruptcy or winding up of the second participant or his principal, will be a better position than the position he would have been in if the transfer had not been made; and
- (c) the second participant in making the transfer, or the second participant's principal in deciding to cause him to make the transfer, is influenced by a desire to produce in relation to the first participant, the effect described in paragraph (b).

(4) At the request of a system operator or settlement institution of a designated system the Monetary Authority may, by notice published in the Gazette, exempt the system operator or settlement institution from the application of this section; and where such an exemption is in effect this section shall not apply in respect of any transfer effected by the system operator or settlement institution (as the case may be) as first participant in his capacity as such system operator or settlement institution.

(5) For the avoidance of doubt, nothing in this section has the effect of derogating from section 18(2) or 20.

27A. Duty to report on completion of default proceedings⁷

(1) The system operator or settlement institution of a designated system shall, upon the completion of any action taken under default arrangements in respect of a defaulting participant, together prepare in writing a report ("default proceedings report") on such action taken.

(2) A default proceedings report –

(a) shall state the net sum (if any) certified by the system operator or settlement institution to be payable by or to the defaulting participant, or the fact that no sum is so payable (as the case may be); and

(b) may contain such other particulars in respect of the action taken as the system operator or settlement institution considers appropriate.

(3) A system operator or settlement institution who has taken part in preparing a default proceedings report shall ensure that the report is supplied to –

(a) the Monetary Authority; and

(b) any relevant insolvency office-holder acting in relation to the defaulting participant to whom the report relates or that defaulting participant's estate or, if there is no such relevant insolvency office-holder, the defaulting participant to whom the report relates.

(4) Where the Monetary Authority receives pursuant to subsection (3) a default proceedings report he may publish notice of that fact in such manner as he considers appropriate to bring it to the attention of creditors of the defaulting participant to whom the report relates.

(5) A relevant insolvency office-holder or defaulting participant who has received pursuant to subsection (3) a default proceedings report, shall, if so requested by a creditor of the defaulting participant to whom the report relates –

⁷ This amendment is proposed in response to the ALA's comment to require a system operator/settlement institution to make a report to the Monetary Authority upon completion of any default proceedings. There is a similar obligation for a recognized clearing house under the Securities and Futures Ordinance.

- (a) make the report available for inspection by the creditor;
- (b) supply to the creditor all or any part of that report, subject to receipt of payment of such reasonable fee as the relevant insolvency office-holder or defaulting participant (as the case may be) determines.
- (6) In subsections (3), (4) and (5), "report" () includes a copy of a report.

28. Obligation of participant to notify of insolvency

(1) A participant in a designated system shall notify any system operator of the system and the Monetary Authority forthwith if there comes to his knowledge any of the following circumstances occurring in Hong Kong, or any analogous circumstances occurring outside Hong Kong, namely –

- (a) any indication in writing by a creditor of the participant of his intention to pass a creditor's voluntary winding-up resolution in respect of the participant;
- (b) the presentation of a petition for the bankruptcy or winding up of the participant;
- (c) the making of an order for bankruptcy or winding up of the participant;
- (d) the passing of a resolution for the voluntary winding up of the participant; or
- (e) the making of a statutory declaration as under section 228A(1) of the Companies Ordinance (Cap. 32) by a director of the participant.

(2) A failure by a participant to notify a system operator or the Monetary Authority of a relevant event referred to in subsection (1) within the time required under that subsection is not a contravention of that subsection if the system operator or Monetary Authority (as the case may be) was already aware of the relevant event by that time.

(3) An exemption granted under section 9 in respect of a designated system may in addition exempt the participants in the system from compliance with subsection (1); and where such an exemption is in effect that subsection shall not apply in relation to such participants.

29. Order releasing relevant insolvency office holder from obligations in relation to default proceedings

A court may, on an application by a relevant insolvency office holder, make such order as it considers appropriate altering or releasing him from compliance with the functions of his office to the extent that those functions are affected by the fact that action under default arrangements is being or could be taken, or has been or could have been taken.

30. Enforcement of judgments over property of participant as judgment debtor

(1) This section applies to any property of a participant in a designated system that –

- (a) has been provided as collateral security in favour of a system operator or settlement institution of the system; and
- (b) is held by or deposited with that system operator or settlement institution for the purpose of securing liabilities arising directly in connection with the clearing or settlement of those transfer orders issued by the participant.

(2) Except with the consent of the system operator or settlement institution mentioned in subsection (1) –

- (a) no execution or other legal process for the enforcement of a judgment or order shall be commenced or continued; and
- (b) no distress shall be levied,

in respect of property to which this section applies; but this subsection does not apply to a person seeking to enforce any interest in or security over the property.

(3) Where by virtue of subsection (2) a person would not be entitled to enforce a judgment or order against any property, any injunction or other remedy granted with a view to facilitating the enforcement of any such judgment or order shall not extend to that property.