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Report of the Bills Committee on
Clearing and Settlement Systems Bill

Purpose

This paper reports on the deliberations of the Bills Committee on Clearing and Settlement Systems Bill (the Bill).

Background

2. Under the Securities and Futures Ordinance (SFO) (Cap. 571), a clearing and settlement system operated by a company recognized as a clearing house providing services for the clearing and settlement of transactions in securities effected on a recognized stock market or for the clearing and settlement of transactions in futures contracts effected on a recognized futures market is subject to the regulation of the Securities and Futures Commission (SFC). There are however no express legal provisions for supervisory oversight of other important clearing and settlement systems in Hong Kong, as follows:

(a) Hong Kong Dollar (HKD) Clearing House Automated Transfer System (CHATS);

(b) US Dollar CHATS;

(c) Euro CHATS;

(d) Central Moneymarkets Unit (CMU);

(e) Cheque Clearing; and

(f) Cash settlement leg for Central Clearing And Settlement System (CCASS) in respect of equities and other securities listed and traded on the Hong Kong Stock Exchange.

3. At present, the systems set out in paragraph 2(a) to (f) above are subject to the de facto oversight of the Monetary Authority (MA) through the exercise of his

general powers under sections 3A(1) and 5B of the Exchange Fund Ordinance (EFO) (Cap. 66), his shareholdings in the Hong Kong Interbank Clearing Limited (HKICL) and contractual agreements with system operators and settlement institutions. However, there is no express statutory backing for the MA's oversight role.

4. Another problem of the existing oversight framework is that there is no statutory provision providing for the finality of settlements effected through clearing and settlement systems operating in Hong Kong to protect settled transactions effected through such systems from insolvency laws. Statutory protection exists only in relation to settlement finality in the CCASS in respect of exchange-traded securities or futures contracts settled through clearing houses recognized by SFC under section 37(1) of SFO.

5. The two problems mentioned above were identified by the International Monetary Fund (IMF) in its assessment of the financial system in Hong Kong. In its report dated 15 April 2003, IMF recommended that there should be explicit legislative provisions for the oversight of clearing and settlement systems and settlement finality for Hong Kong's clearing and settlement systems for funds and securities.

6. To address the two problems mentioned above and to facilitate the admission of HKD into the Continuous Linked Settlement (CLS) System[Note 1], the Administration introduced the Bill into the Legislative Council (LegCo) on 10 December 2003.

The Bill

7. The objectives of the Bill are to provide express statutory backing for the oversight role of MA in relation to important clearing and settlement systems in Hong Kong and for the finality of settlements effected through such systems.

The Bills Committee

8. The House Committee agreed at its meeting on 12 December 2003 to form a Bills Committee to study the Bill. The Bills Committee first met on 18 March 2004 and Hon SIN Chung-kai was elected Chairman. The membership list of the Bills Committee is in **Appendix I**. The Bills Committee held a total of seven meetings.

Note 1

The CLS System is a global clearing and settlement system for cross-border foreign exchange transactions. Eleven major international currencies, including the US dollar, euro, sterling and yen, have already been admitted into the System. As in other jurisdictions, the CLS System requires, as a pre-condition for the admission of HKD, that the laws of Hong Kong provide for settlement finality as regards transactions within the CLS system and within the underlying Real Time Gross Settlement System in Hong Kong.

9. The Bills Committee notes that the Administration has conducted several rounds of consultation on the proposed legislative provisions with SFC, Hong Kong Exchanges and Clearing Limited (HKEx), the relevant payment system operators, the Hong Kong Association of Banks (HKAB), leading insolvency practitioners and settlement institution, the Official Receiver, the Law Society of Hong Kong, the Hong Kong Bar Association and the Hong Kong Society of Accountants (HKSA). To ascertain whether the relevant organizations have any further views on the Bill, the Bills Committee has invited submissions from them and subsequently received a submission from HKEx.

Deliberations of the Bills Committee

10. The Bills Committee supports the objectives of the Bill. The Bills Committee is advised by the Administration that statutory oversight of clearing and settlement systems and statutory protection to ensure settlement finality are provided in some overseas jurisdictions, such as Australia, New Zealand, Canada, and the European Union. To ensure that the proposed statutory framework under the Bill is effective, the Bills Committee has examined the following issues in detail:

(a) Proposed designation and oversight regime;

(b) Proposed settlement finality;

(c) Appeals mechanism;

(d) Offences; and

(e) Extra-territorial application of the Bill.

<u>Proposed designation and oversight regime</u>
(Part 2 of the Bill)

Criteria for designation and list of designated systems

11. The Bills Committee notes that under clause 3(1), MA may, by notice published in the Gazette, designate for the purposes of the Bill any clearing and settlement system if the system is in operation in Hong Kong or accepts for clearing or settlement transfer orders denominated in HKD, and if, in the opinion of MA, 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. Members note that under these criteria, the proposed regime will effectively cover all the important clearing and settlement systems set out in paragraph 2(a) to (f) above. While members have no objection to the proposed criteria for designation, they are concerned that under the proposed gazettal arrangement, members of the public who need to check whether a clearing and settlement system is a designated system under the Bill may have to go through

various notices published in the Gazette. To facilitate members of the public, the Administration is invited to provide a list of designated clearing and settlement systems for their easy reference. Having considered some suggested options, the Administration believes that the most effective means to provide timely information to the public is to maintain an updated list of designated systems on the website of the Hong Kong Monetary Authority (HKMA). It also points out that HKMA publishes the current list of authorized institutions under the Banking Ordinance (BO) (Cap. 155) on its website. The Bills Committee accepts this arrangement.

Systems deemed to have been designated

12. The Bills Committee notes that under clause 54, for systems that are specified in Schedule 2 to the Bill, i.e. HKD CHATS and CMU which are operated by MA, they are deemed to have been designated and a certificate of finality is deemed to have been issued in respect of each of such systems. Members consider it not appropriate to exempt such systems from the statutory oversight requirements under Part 2 of the Bill as proposed under clause 54(3), and request the Administration to provide information on overseas practices in this regard. Members note that in Australia, Canada and the European Union where a statutory oversight regime has been established, the clearing and settlement systems owned or operated by central banks are also subject to statutory oversight requirements. In view of these findings, the Administration shares members' view that it may not be appropriate to exempt the systems operated by MA from the statutory oversight requirements under Part 2 of the Bill. The Administration agrees to move a Committee Stage amendment (CSA) to delete clause 54(3).

Principal obligations of designated systems

13. The Bills Committee notes that under the Bill, every person who is a system operator or settlement institution of a designated system is required to inform MA in writing of his particulars within three days of the designation (clause 5(1)), and of the change to the particulars within three days of the change taking effect (clause 5(2)). The Bills Committee has no objection to the Administration's proposal to extend the time limit in clause 5(1) and (2) from three days to six days, which is introduced to address the concern of banks that the time limit of three days appears to be too short. The Administration will move CSAs to effect these changes.

14. The Bills Committee however notes that under clause 39(1), a person who, without reasonable excuse, contravenes clause 5(1) or (2) commits an offence and is liable on conviction upon indictment to a fine of $400,000 and to imprisonment for two years. Members consider it too harsh to impose imprisonment terms on a convicted offender who contravenes clause 5(2), i.e. who fails to inform HKMA of the change of the particulars of the system operator or settlement institution of a designated system within six days of the change taking effect. To address members' concern, the Administration agrees to move a CSA to clause 39 to the effect that a person who contravenes clause 5(2), on conviction upon indictment, will be liable to a fine of $400,000 but not to imprisonment.

Functions of MA

15. The Bills Committee notes that clause 8(1) provides that it shall be the function of MA both to monitor compliance of designated systems with the provisions of the oversight regime and to promote the safety and efficiency of their operations. Under clause 8(3), MA may appoint persons as agents or advisers to assist him in the performance of his functions under the Bill. Some members are concerned whether clause 8(3) is superfluous given that section 5A(3) of EFO provides that the Financial Secretary (FS) may appoint persons to assist MA in the performance of his functions under EFO and any other Ordinance. Members are advised by the Administration that section 5A(3) of EFO provides for the appointment by FS, not by MA. Although MA could make the appointment if he has been so delegated under section 5B of EFO, the Administration considers it appropriate to retain clause 8(3) as this would allow MA to employ advisers or consultants for the purposes of the Bill directly.

16. While members have no objection to retain clause 8(3), they are concerned about the expression "appoint persons as agents" in the subclause, as it seems to imply that MA may delegate his authority to the appointed agents. If that is the case, the appointed agents may perform MA's functions under delegated authority, instead of taking up an assisting role. In this connection, members note the Administration's clarification that "agents" appointed under clause 8(3) are to assist MA in the performance of his functions under the Bill. The subclause does not suggest in any sense that MA would delegate his functions and powers under the Bill to the agents. The word "agents" is also used in section 9(3) of SFO. In order to address members' concern about the reference to the appointment of "agents", the Administration will move a CSA to refer to the appointment of advisers or consultants and drop the reference to "agents". The Bills Committee is assured by the Administration that in any event, the appointment of advisers or consultants would not relieve MA of his duties under the Bill.

Power of MA to request information

17. The Bills Committee notes that under the Bill, MA may request information to enable him to perform his functions thereunder:

(a) For the better carrying out of his functions under the Bill, MA may request a system operator or settlement institution of a designated system to give him information relating to the system (clause 10);

(b) Where there are reasonable grounds for believing that a clearing and settlement system exists, but MA is unable on the basis of the information before him to determine whether the system is eligible to be designated or, if eligible to be, should be designated under the Bill, MA may request the system operator or settlement institution of the system or a participant in the system to give him such

information or documents regarding the system as MA considers may assist him in making that determination (clause 51); and

(c) Where any action has been taken under the default arrangements of a designated system in respect of a participant in the system, MA may direct the system operator or settlement institution of the system to provide to a nominated official such information as the nominated official may request relating to that default (clause 52).

18. The Bills Committee is concerned whether the system operator or settlement institution of a designated system could refuse to provide information on the ground that it is covered by the common law privileges like legal professional privilege and the privilege against self-incrimination. The Bills Committee is advised by the Administration that its policy intent is that such privileges would not be affected by the requirements in clauses 10, 51 and 52. In the event of non-compliance with a request for information under the three clauses and the privileges being claimed, HKMA could rely on the offence provisions under clauses 39 and 42 to have the matter decided by the court.

19. In this connection, members are concerned that while failure to comply with the requirement to give information under clauses 10 and 51 is an offence under the Bill, no similar sanction is provided for failure to comply with a request for information under clause 52. Members note the Administration's advice that the sanction for non-compliance with clause 52(4) is suspension or revocation of the certificate of finality (clause 15(1)(b)). In the light of members' concern, the Administration agrees that it is necessary to introduce an appropriate offence provision. The Administration will move a CSA to clause 42 to provide that a person who, without reasonable excuse, contravenes clause 52(4) commits an offence and is liable on conviction upon indictment to a fine of $400,000 and to imprisonment for two years.

Power of MA to issue guidelines and make regulations

20. The Bills Committee notes that MA may 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, under the Bill (clause 53). Members suggest that clause 53 be amended to stipulate that MA is required to consult the system operators and settlement institutions of designated systems before issuing the guidelines. The Administration accepts members' suggestion and agrees to move a CSA to clause 53 to that effect.

21. In connection with the above, the Administration considers that the consultation requirement should also apply to the making of regulations by MA under clause 48. The Administration will move a CSA to clause 48 accordingly.

Avoidance of regulatory overlap

22. The Bills Committee notes that for the purpose of avoiding regulatory overlap with SFC, clause 3(2) provides that the power to designate will not apply to a clearing and settlement system that is, or is operated by, a company recognized as a clearing house under section 37(1) of SFO. Members enquire about whether the converse would be the same, i.e. if MA has designated a clearing and settlement system under the Bill, whether SFC would refrain from giving recognition to the same system under section 37(1) of SFO and would withdraw such recognition if already given by SFC. The Administration considers it not necessary to seek reciprocal treatment from SFC. In practice, HKMA and 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.

23. The Bills Committee notes that the Hong Kong Securities Clearing Company Limited (HKSCC), which is a wholly-owned subsidiary of HKEx, is a recognized clearing house under SFO as well as a participant in CMU. HKEx is concerned about the possibility that the regulatory requirements imposed on HKSCC by SFC under SFO and by HKMA under the Bill might be incompatible, thus putting HKSCC in a difficult position. The Bills Committee is assured by the Administration that the regime proposed under the Bill would not result in regulatory overlap between HKMA and SFC, as the regulatory requirements are primarily imposed on a system operator or settlement institution rather than a participant in a designated system. There is no specific example in which such regulatory overlap is currently envisaged. Notwithstanding the above, the Administration appreciates that there should be a reliable arrangement amongst the parties concerned to minimize any possible regulatory overlap and avoid the introduction of any incompatible regulatory requirements which make it impossible for HKSCC to comply. HKMA and SFC would consult each other on rules to be promulgated under the Bill and SFO to iron out any incompatibility between those rules imposed on recognized clearing houses under SFO and those on designated systems under the Bill. In this connection, HKMA and SFC would be prepared to enter into a memorandum of understanding to set out the relevant consultation procedures. The Bills Committee notes that HKEx welcomes this arrangement, and that the Administration would refer to this arrangement in the Secretary for Financial Services and the Treasury (SFST)'s speech in resuming the Second Reading debate on the Bill.

Possible role conflict of HKMA

24. The Bills Committee notes that HKMA is the owner/operator of HKD CHATS and CMU, and that HKMA has a 50% shareholding in HKICL, which is the system operator for some important clearing and settlement systems in Hong Kong. Members express concern that there might be a role conflict when HKMA conducts oversight of such clearing and settlement systems in which HKMA has a direct or indirect interest (hereafter referred to as "HKMA systems"), and request the Administration to provide information on overseas practices in this regard. Members

are advised by the Administration that all the central banks in Australia, Canada, the European Union, the United Kingdom and the United States have responsibilities for the oversight function as well as being the operator/settlement institution/owner of certain key clearing and settlement systems. 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 the five economies mentioned above have the oversight function and the system operations function undertaken by different and separate units within the central banks, which will also be the case at HKMA.

25. To strengthen the institutional arrangements to avoid any perceived or potential conflict of HKMA's roles as an overseer as well as a system operator, members invite the Administration to consider setting 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. Members also stress the importance of having a "Chinese wall" between the operational and oversight teams of HKMA for clear segregation of duties. Members are advised by the Administration that upon enactment of the Bill, 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 systems including HKD CHATS and CMU and also for the participation in HKICL to promote the development of financial market infrastructures. Members are assured by the Administration that HKMA will ensure that a proper Chinese wall is in place to segregate the operations of the two different divisions with respect to the oversight of HKMA systems. The relevant operational procedures of the new division will also be subject to compliance checks by the Internal Auditor of HKMA.

26. The Bills Committee is also advised by the Administration that there will be checks and balances on the exercise of the HKMA's oversight powers under the statutory oversight regime. Under the proposed appeals mechanism in the Bill, an aggrieved system operator or settlement institution can appeal against the MA's decisions. The MA's decisions will then be subject to an impartial review by the Clearing and Settlement Systems Appeals Tribunal (CSSAT). Moreover, 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 HKMA on HKMA systems as against non-HKMA systems. Moreover, the banks through HKAB have a 50% stake in HKICL. They also take part in the governance of HKICL and would not hesitate to ensure that the same standards are applied by 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 HKAB. Should there be any

preferential rules for HKMA systems, they would be readily noticeable and rectified before approval.

27. Notwithstanding the various checks and balances mentioned above, members consider that, once a formal statutory oversight regime to be administrated by HKMA is established, there is a need to ensure impartiality and level playing field for the HKMA systems and other systems. The Administration accepts members' view and proposes to set up an independent process review committee, to be appointed by the Chief Executive (CE) 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 the setting of standards and conditions, and the adherence to the due process in enforcing compliance with such standards and conditions. It is proposed that both the chairman and members of the committee will be independent persons appointed by CE. The committee will consider the above issues and prepare annual reports to FS. It is envisaged that FS shall cause these reports to be published in the interest of transparency and accountability. The proposed terms of reference of the process review committee is in **Appendix II**.

28. In light of the experience with the Process Review Panel set up for SFC by CE, the Administration considers it appropriate to have the process review committee set up on an administrative basis. The Bills Committee accepts this arrangement.

29. The Bills Committee also accepts the Administration's proposal of introducing a CSA to clause 49 in order to allow the disclosure of confidential information regarding the HKMA's oversight activities relating to HKMA systems to the process review committee.

Proposed settlement finality
(Part 3 of the Bill)

30. The Bills Committee notes that the proposed settlement finality regime is to provide statutory protection of the integrity of transfer orders settled through designated systems from the insolvency and other laws in Hong Kong and overseas. This is to ensure that transfer orders settled through designated systems are irrevocable and not disrupted by the insolvency of participants, whereas any rights resulting from the underlying transactions of such transfer orders will not be affected. Besides transfer orders, the Bill provides legal certainty on the netting arrangements in designated systems. Netting arrangements are protected from the risk of unwinding arising from the insolvency and other laws in Hong Kong and overseas. Participants' interests in collateral security under the default arrangements of designated systems are also protected.

Issuance, suspension and revocation of certificate of finality

31. The Bills Committee notes that under the Bill, MA is empowered to issue a certificate of finality to a designated system (clause 14) if the system effects ultimate settlement of transfer orders and is in compliance with the requirements in the Bill

regarding, mainly, the safety and efficiency of the system. This certificate of finality can be revoked or suspended by MA if either of the above conditions cannot be met, or if there has been any contravention of certain requirements under the Bill (clause 15). To enhance the transparency of the MA's decisions, members consider that MA should publish in the Gazette notice of the issuance, suspension and revocation of a certificate of finality for information. The Administration accepts members' view and agrees to move CSAs to clauses 14 and 15 accordingly.

32. To avoid uncertainty as to the date and time from which a certificate of finality shall take effect, members consider it advisable for MA to specify the date and time in the certificate. Members also consider that the time at which the suspension or revocation of the certificate shall take effect should be expressly provided for in the notice of suspension or revocation. The Administration accepts members' views and agrees to move CSAs to clauses 14 and 15 accordingly. The Administration also confirms that there will not be retrospective revocation.

Finality of transactions and proceedings within designated systems

33. The Bills Committee notes that clause 22 provides that Division 3 (Finality of transactions and proceedings within designated systems) of Part 3 of the Bill does not apply in relation to transfer orders that are entered into a designated system after a point in time specified in that provision, essentially after insolvency has occurred. The Bills Committee has no objection to the Administration's proposed CSAs to amend clause 22 to remove any uncertainty in applying the provision, which is introduced in response to the request of CLS.

Underlying transactions

34. The Bills Committee notes that clause 25 provides that the Bill does not affect rights arising from the underlying transactions in respect of transfer orders, except to the extent that Part 3 of the Bill (Finality of transactions and proceedings) expressly provides. Falling short of reversing the transfer orders, an insolvency office-holder still has the right to go after the underlying transactions. The Bill has specifically addressed two types of situations, as follows:

(a) Clause 26 addresses the situation where a participant who subsequently becomes insolvent has entered into a transaction at an undervalue with another participant and confers on a relevant insolvency office-holder the right to recover from the other participant the amount of any gain made from the transaction; and

(b) Clause 27 addresses the situation where a participant who subsequently becomes insolvent has made a transfer that gives an unfair preference to another participant and confers on a relevant insolvency office-holder the right to recover from the other participant the value of the transfer.

35. HKSA has copied to the Bills Committee its written submission about clauses 25, 26 and 27 to the Administration. From an insolvency practitioner's point of view, HKSA considers it important that rights to challenge underlying transactions are clearly not affected by the Bill. HKSA is concerned that the expression at the beginning of clause 25(1), "Except to the extent that it [Part 3 of the Bill] expressly provides", may in some way provide for a limitation or restriction of rights to challenge underlying transactions. Given that there is no express provision in Part 3 of the Bill that affects the rights resulting from the underlying transactions, HKSA queries the need for the expression in question. The Bills Committee invites the Administration to consider HKSA's views. The Administration points out that the expression in question may help to clarify the protection of the integrity of transfer orders in case rights in respect of the latter may overlap with those of the underlying transactions. To address HKSA's concern, however, and with no objection from CLS, the Administration agrees to move a CSA to delete the expression from clause 25(1).

36. The Bills Committee notes that under clauses 26(4) and 27(4), at the request of a system operator or settlement institution of a designated system, MA may, by notice published in the Gazette, exempt the system operator or settlement institution from the application of clauses 26 and 27. Responding to HKSA's concern about the circumstances under which such exemptions would be granted, the Administration clarifies that the policy intention, as reflected in the specific wording of the provisions, is to grant the exemptions for transactions entered into by a system operator or settlement institution (as the case may be) as first participant in its respective capacity as the system operator or settlement institution only. Such exemptions will not be granted in respect of transactions entered into by a system operator or settlement institution as a participant or user of the designated system. The Bills Committee notes that the Administration has conveyed the policy intention to HKSA.

37. The Bills Committee notes that the right to recover gain from transaction at undervalue between two participants under clause 26 and the right to recover transfer between two participants giving unfair preference under clause 27 are exercisable in the case of a creditors' voluntary winding-up, but not exercisable in the event that a winding up statement is made by the directors pursuant to section 228A(1) of the Companies Ordinance (Cap. 32). The Administration agrees that the same considerations should apply in the case of a company’s voluntary winding-up as in the case of a winding-up by its creditors, and that CSAs will be moved to amend clauses 26(1) and 27(1) accordingly. Similar amendments will be made to clauses 21(2), 22(1) and 23(1). In this connection, the definition of "directors' voluntary winding up statement" will be added to clause 2. Moreover, the definition of "resolution for voluntary winding up" will also be added.

Duty to report on completion of default proceedings

38. The Bills Committee notes that under SFO, a recognised clearing house is under a duty to make a report on completion of default proceedings. Members suggest that the Administration should consider the need for providing similar provisions in respect of designated systems under the Bill. The Administration agrees that a similar

approach should be adopted for the designated systems under the Bill and that a CSA will be moved to add the new clause 27A for this purpose.

39. The Bills Committee notes that the Hong Kong and Shanghai Banking Corporation (HSBC) has written to the Administration, expressing its concern that there is a time limit for preparing and submitting a default proceedings report under the new clause 27A and contravention of the requirement is an offence where company officers could be held liable. Whilst appreciating HSBC's concern, the Administration points out that the Bill has to impose reasonable requirements and appropriate sanctions to ensure that the oversight regime being established would function properly and achieve its purpose. On the new clause 27A, the Administration considers six working days sufficient to prepare a report on a default case. In response to HSBC's request, HKMA has undertaken to provide guidance to designated systems on how action taken under the default arrangements of the systems should be reported.

Appeals mechanism
(Part 4 of the Bill)

40. The Bills Committee notes that clauses 32 and 33 provide for the establishment of an independent CSSAT to hear appeals by any person who is aggrieved by a decision of 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 CSSAT for review within 30 days after the decision is made by MA or within such further time that MA thinks fit (clause 33). CSSAT will consist of a Chairman who is appointed by CE on the recommendation of the Chief Justice, and not fewer than two panel members who are appointed by FS on the Chairman's recommendation (clause 32 and Schedule 1).

41. In examining the provisions on the proposed CSSAT, the Bills Committee has compared the provisions with relevant provisions on the proposed Deposit Protection Appeals Tribunal (DPAT) under the Deposit Protection Scheme Bill[Note 2], the Securities and Futures Appeals Tribunal (SFAT) and the Market Misconduct Tribunal under SFO. On clause 37 which provides for appeals to the Court of Appeal against determinations of CSSAT on a point of law, members invite the Administration to consider including an express provision providing that the lodging of an appeal to the Court of Appeal does not by itself operate as a stay of execution of a determination of CSSAT unless the Court of Appeal otherwise orders, similar to that provided in SFO in respect of SFAT. The Administration agrees to introduce such an express provision in the Bill and will move a CSA to clause 37 accordingly.

42. The Bills Committee notes that clause 37(2) provides that the Court of Appeal may affirm, reverse or vary the determination appealed against. Members suggest that the Administration should consider replacing "reverse" by "set aside" to achieve consistency with the wording in clause 33(6)(a) and providing that the Court

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Note 2

The Deposit Protection Scheme Bill was passed by LegCo on 5 May 2004.

of Appeal may remit the matter in question to CSSAT with such directions as it considers appropriate. The Administration accepts members' suggestion and agrees to move CSAs to clause 37(2) accordingly.

43. Regarding clause 33, the Bills Committee has no objection to the Administration's proposal to move a CSA to provide that the further time within which a person could refer a case to CSSAT is to be determined by CSSAT but not by MA. This is considered appropriate since it is MA's decision that is the subject for review.

Offences
(Part 5 of the Bill)

44. The Bills Committee notes that clause 44 makes it an offence for a person to describe or otherwise make any representation in respect of a clearing and settlement system that is not a designated system, or in respect of a clearing and settlement system in respect of which a certificate of finality is not in effect, in a manner that indicates that the system is a designated system or a certificate of finality is in effect in respect of the system. Members are concerned about the expression "in a manner that indicates", which may involve subjective judgement. Members are advised by the Administration that defence provisions are provided in clause 44(2) and (4) under which it is a defence for a person charged with the offences in question to prove that he reasonably believed that the system was a designated system or that a certificate of finality was in effect in respect of the system. To address members' concern, the Administration proposes to move CSAs to clause 44(1) and (3) to replace the expression "in a manner that indicates" by "in terms that indicate". The Bills Committee accepts the proposed change.

45. The Bills Committee notes that clause 45 creates offences relating to false entries, omission to make entries, and alteration, abstraction, concealment or destruction of entries in a book of record or in certain documents related to a designated system. Members are concerned whether it is justified to impose a penalty of a fine of $1,000,000 and imprisonment for five years on a person who has committed such offences. The Administration points out that a person only commits an offence if he does the act wilfully and with intent to deceive (clause 45(1)), and that for serious offences of such nature, the maximum penalty is five years of imprisonment.

46. The Bills Committee notes that clause 46 attributes personal liability to the officers of a corporation in respect of offences committed under certain provisions of the Bill, where the officer participated in or caused the act or omission in question. To address the concerns expressed by some relevant organizations, the Administration proposes to move CSAs to clause 46 to improve its clarity and to add the definition of "officer" in clause 2. Noting the Administration's advice that clause 46 follows the approach adopted in section 390 of SFO and that the proposed definition of "officer" is similar to that of the same term provided in Schedule 1 to SFO, members suggest that the definition of "officer" provided in SFO should be adopted for this Bill. The

Administration accepts members' suggestion and agrees to amend the proposed definition of "officer" in clause 2 accordingly.

47. Some members express concern about the disparity in the levels of fine and/or years of imprisonment under the penalty provisions in clauses 40, 41, 42 and 45. Members note the Administration's explanation that where an offence is likely to be committed by an individual rather than a corporation, the fine is relatively less; where an offence is likely to be committed by a corporation, it is common to set a relatively higher level of fines to achieve the deterrent effect, as imprisonment does not apply to corporations. The Administration also advises that the level of penalty under the Bill is determined with reference to section 123 of BO.

Extra-territorial application of the Bill

48. Noting that clause 3(2) provides that a clearing and settlement system may be designated if it is in operation in Hong Kong, the Bills Committee is concerned 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 are covered by the Bill. In this connection, the Administration is invited to clarify whether the Bill has extra-territorial effect.

49. The Bills Committee is advised by the Administration that in general, the Bill has extra-territorial application only to the extent that MA may for the purposes of the Bill designate a clearing and settlement system if it accepts for clearing or settlement transfer orders denominated in HKD, albeit the system is in operation outside Hong Kong. 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. Only through an extra-territorial application of the Bill can MA ensure that the safety and efficiency of a designated system, regardless of where it operates, is up to the standards that MA requires. As regards settlement finality, a designated system accepting HKD denominated transfer orders settled outside Hong Kong enjoys protection from possible unwinding due to the insolvency or other laws of Hong Kong. In the Administration's view, 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.

50. The Bills committee is also advised by the Administration that the extra-territorial application of the Bill is not a unique arrangement. Under section 95 of SFO, SFC can authorize a person to provide automated trading services (ATS). SFO also empowers 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.

51. To facilitate the Bills Committee to consider the issue, members request the Administration to provide information on international practices on extra-territorial application of the relevant legislation. The Bills Committee is advised by the

Administration 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 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. The Administration however points out that the trend of establishing a statutory oversight regime on clearing and settlement systems has only started to evolve in recent years.

52. Whilst having no objection to the extra-territorial application of the Bill, members consider that such application should be clearly set out in the Bill. The Administration accepts members' view and agrees to move CSAs to add a new clause 2A (Application) and to add a new subclause (3) to clause 51 (Power of Monetary Authority to require information to be given) for this purpose.

Miscellaneous amendments

53. The Bills Committee notes that clause 50 confers immunity on persons acting in good faith in the exercise of functions under the Bill. In response to the concern of members and the market, the Administration agrees to move CSAs to make it clear that the immunity under clause 50 covers civil liability only.

54. To address the Bills Committee's concern, the Administration agrees to move a CSA to add the new clause 57 to set out clearly that a notice published under clause 56 is subsidiary legislation for the purposes of section 34 of Cap. 1, and that other notices and the guidelines published in the Gazette under the Bill are not subsidiary legislation.

55. There are some other minor proposed amendments to various parts of the Bill, which are agreed by both the Bills Committee and the Administration.

Committee Stage amendments

56. The Bills Committee has no objection to CSAs proposed by the Administration. The Bills Committee has not proposed any CSAs.

Recommendation

57. The Bills Committee supports the Administration's proposal that the Second Reading debate on the Bill be resumed on 30 June 2004.

Consultation with House Committee

58. The House Committee, at its meeting on 11 June 2004, supported the recommendation of the Bills Committee in paragraph 57 above.

59. On 14 June 2004, the Administration informed the Bills Committee in writing that it would introduce a minor technical refinement to the new clause 57(1). The Administration's letter (with details of the technical refinement) was issued to members of the Bills Committee and copied to all other Members vide LC Paper No. CB(1)2160/03-04 on 15 June 2004.

Council Business Division 1
Legislative Council Secretariat
18 June 2004

附錄I
Appendix I

《結算及交收系統條例草案》委員會
Bills Committee on Clearing and Settlement Systems Bill

委員名單
Membership List

主席 **Chairman**	單仲偕議員	Hon SIN Chung-kai
委員 **Members**	李國寶議員, GBS, JP	Dr Hon David LI Kwok-po, GBS, JP
	吳亮星議員, JP	Hon NG Leung-sing, JP
	陳智思議員, JP	Hon Bernard CHAN, JP
	曾鈺成議員, GBS, JP	Hon Jasper TSANG Yok-sing, GBS, JP
	劉漢銓議員, GBS, JP	Hon Ambrose LAU Hon-chuen, GBS, JP
	石禮謙議員, JP	Hon Abraham SHEK Lai-him, JP
	胡經昌議員, BBS, JP	Hon Henry WU King-cheong, BBS, JP
	(共8名委員) (Total : 8 members)	
秘書 **Clerk**	陳美卿小姐	Miss Salumi CHAN
法律顧問 **Legal Adviser**	馮秀娟女士	Ms Connie FUNG
日期 **Date**	2004年3月18日 18 March 2004	

Appendix II

Proposed terms of reference of the Process Review Committee

1. To review and advise the HKMA upon the adequacy of the HKMA's internal operational procedures and guidelines for applying the standards set under the Clearing and Settlement Systems Ordinance (CSSO) to those designated systems in which the HKMA has a legal or beneficial interest;

2. To receive and consider periodic reports from the HKMA on all completed or discontinued files in respect of alleged non-compliance of the CSSO by those designated systems in which the HKMA has a legal or beneficial interest; and

3. To submit annual reports and, if appropriate, special reports on designated systems in which the HKMA has a legal or beneficial interest, to the Financial Secretary.