

立法會
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**Paper for the House Committee Meeting
on 12 December 2003**

**Legal Service Division Report on
Clearing and Settlement Systems Bill**

I SUMMARY

- 1. Object of the Bill** To provide a statutory framework under which the Monetary Authority (MA) is empowered to oversee certain clearing and settlement systems for funds and securities in Hong Kong, and to provide for finality as regards transactions effected through, and proceedings within, such systems.
- 2. Comments**

 - (a) The proposed statutory oversight framework will apply to important clearing and settlement systems that have implications for the monetary or financial stability of Hong Kong or for the functioning of Hong Kong as an international financial centre.
 - (b) There will not be regulatory overlap with the Securities and Futures Commission under the Securities and Futures Ordinance (Cap. 571).
 - (c) Various regulatory powers will be conferred on MA to enable him to perform his oversight function.
 - (d) To ensure finality as regards transactions and proceedings within clearing and settlement systems designated by MA, the Bill proposes certain modification of the laws relating to bankruptcy and winding up in their application to transactions effected through and proceedings within such systems.
 - (e) Criminal sanction is proposed for non-compliance with certain requirements or obligations under the Bill.
- 3. Public Consultation** Banks, operators of clearing and settlement systems and relevant professional bodies have been consulted.
- 4. Consultation with LegCo Panel** The policy aspects of the Bill were discussed at the meeting of the Panel on Financial Affairs on 5 May 2003.
- 5. Conclusion**

 - (a) The Bill is likely to have important implications for the monetary or financial stability of Hong Kong.
 - (b) A Bills Committee is recommended to be formed.

II REPORT

Object of the Bill

To provide a statutory framework under which the Monetary Authority is empowered to oversee certain clearing and settlement systems for funds and securities operating in Hong Kong, and to provide for finality as regards transactions effected through, and proceedings within, such systems.

LegCo Brief Reference

2. B9/32C issued by the Financial Services and the Treasury Bureau dated 26 November 2003.

Date of First Reading

3. 10 December 2003.

Background

4. Under the Securities and Futures Ordinance (Cap. 571) ("SFO"), 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 provisions for supervisory oversight of other clearing and settlement systems. These other systems include the Hong Kong Dollar Clearing House Automated Transfer System ("CHATS"), US Dollar CHATS, Euro CHATS, Central Moneymarkets Unit, Cheque Clearing and the cash settlement leg for Central Clearing And Settlement System in respect of equities and other securities listed and traded on the Hong Kong Stock Exchange. At present, these systems are subject to the de facto oversight of the Monetary Authority ("MA") through the exercise of his general powers under the Exchange Fund Ordinance (Cap. 66), his shareholdings in the Hong Kong Interbank Clearing Limited ("HKICL") and contract agreements with system operators.

5. Except the SFO which exempts only recognized clearing houses in respect of exchange-traded securities or futures contracts from insolvency laws, there are at present no statutory provisions 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.

6. The above problems were identified by the International Monetary Fund ("IMF") in a recent assessment of the financial system in Hong Kong. In its report, the IMF recommends that there should be explicit legislative provisions for oversight of clearing and settlement systems and settlement finality in Hong Kong's important payment systems.

Comments

7. The Bill proposes to implement the IMF's recommendations as set out in paragraph 6 above. The important features of the Bill are summarized below:

Statutory framework for oversight of clearing and settlement systems

8. Under the Bill, the MA will be empowered to designate any clearing and settlement system ("the designated system") to be subject to the oversight of the MA if the system meets certain specified criteria. The proposed oversight regime will only apply to those important clearing and settlement systems that have implications for the stability of the monetary or financial system in Hong Kong or the functioning of Hong Kong as an international financial centre. Under these criteria, the proposed regime will effectively cover all the important payment systems that are currently subject to the de facto oversight of the MA. To avoid regulatory overlap with the SFC under the SFO, it is proposed that the power to designate under this Bill will not apply to a clearing and settlement system that is, or is operated by, a company recognized as a clearing house under the SFO.

9. To ensure the safety and efficiency of designated systems, the Bill imposes various obligations on a system operator or settlement institution of a designated system. These obligations include conducting the system in a safe and efficient manner, establishing appropriate operating rules providing for safety and efficiency related matters and providing sufficient financial resources to the system.

10. To enable the MA to perform his function of overseeing designated systems, the Bill proposes to confer on the MA the following powers:

- (a) the power to request information from a designated system and to give directions to a designated system for the purpose of bringing the system into compliance with the requirements under the Bill;
- (b) the power to amend the operating rules of a designated system to bring the rules into compliance with the Bill;
- (c) the power to make regulations in relation to the oversight of designated systems to ensure the safety, efficiency and financial soundness of designated systems; and
- (d) the power to revoke the designation of a designated system if the system no longer meets the criteria specified under the Bill.

Finality of settlement

11. In the context of clearing and settlement systems, finality refers to the abrogation of all rights otherwise existing at law that would allow the setting aside of transactions effected through, or proceedings within, such systems. Such rights

would include, for example, rights under the law of bankruptcy by which a transaction involving an insolvent participant could be set aside or otherwise interfered with.

12. The Bill proposes to confer on the MA the power to issue a certificate of finality if he determines that certain specified criteria have been met as regards a designated system. If a certificate of finality is issued in respect of a designated system, the provisions relating to finality of transactions and proceedings within designated systems proposed in the Bill will apply to that system.

13. Clauses 16 to 30 of the Bill, which provide for matters relating to the finality of transactions and proceedings within designated systems, are similar to the provisions under the SFO which protect transactions and proceedings of recognized clearing houses from insolvency laws. To ensure finality of transactions and proceedings within designated systems, the Bill provides for modification of the laws relating to bankruptcy and winding up in their application to transactions effected through and proceedings within such systems. For example, it is proposed that the powers of a relevant insolvency office holder such as the Official Receiver, a liquidator of a company or a trustee in bankruptcy, and the powers of a court acting under insolvency laws, are not to be exercised in such a way as to prevent or interfere with the transactions and proceedings within a designated system.

Other provisions

14. Other more important provisions of the Bill provide for the establishment of an independent tribunal to hear appeals against certain decisions made by the MA under the Bill and for criminal sanctions for non-compliance with various requirements or obligations under the Bill.

Commencement of the Bill

15. If enacted, the Bill will come into operation on a day to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

Public Consultation

16. According to paragraph 28 of the LegCo Brief, the Administration has conducted several rounds of consultations with the SFC, the Hong Kong Exchanges and Clearing Limited, the relevant payment system operators, the Hong Kong Association of Banks, leading insolvency practitioners, the Official Receiver, the Law Society of Hong Kong, the Hong Kong Bar Association and the Hong Kong Society of Accountants. According to the Administration, there is general support from the parties consulted and their relevant concerns have been addressed where appropriate.

Consultation with LegCo Panel

17. The Panel on Financial Affairs was consulted on the policy aspects of the Bill at its meeting on 5 May 2003. At the meeting, members of the Panel raised various questions, including whether the MA's role as shareholder of the HKICL would conflict with his role as regulator of clearing and settlement systems after enactment of the Bill and the international practices on the oversight role of regulators of clearing and settlement systems. The Administration has explained that the MA's ownership of the HKICL is in the public interest particularly from the perspective of development of market infrastructure and in line with international practices, and accordingly there are good reasons for the MA to retain its shareholding in the HKICL even with the introduction of a statutory oversight framework (LC Paper No. CB(1)1790/02-03 refers).

Conclusion

18. The Legal Service Division is scrutinizing the Bill and will seek clarification from the Administration on the legal and drafting aspects of the Bill. In view of the importance of the Bill to the stability of the monetary or financial system in Hong Kong, Members may wish to form a Bills Committee to study the Bill in detail.

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