Bills Committee on Clearing and Settlement Systems (Amendment) Bill 2015

Government's Response to Submission from the Hong Kong Association of Banks

Category	Views	Government's Response
General	• Support the policy intent of the Bill.	• Noted.
Definitions of "system operator" and "settlement institution"	• There seems to be some overlap in the two definitions as both of them involve providing settlement functions. The settlement functions of a "settlement institution" should be described in a similar way in the existing Ordinance, so that the relevant definition involves the provision of settlement accounts to participants in the facility and any central counterparty.	• As a "settlement institution" of a retail payment system ("RPS") may not necessarily involve the provision of settlement accounts to participants, it is not appropriate to adopt in relation to a RPS the existing definition of "settlement institution" in the existing Clearing and Settlement Systems Ordinance ("the Ordinance"), which applies to large-value clearing and settlement systems, in the Bill. We therefore propose defining a "settlement institution" to mean, in relation to a RPS, a person providing services for the settlement of any payment obligation relating to retail activities for the purposes of the operating rules of the system.

Category	Views	Government's Response
Definition of "stored value facility" ("SVF")	• Whilst the use of the word "issuer" in the definition of SVF is appropriate in relation to a card-based facility, it may not be appropriate for a facility which is not card-based. Alternative terminology such as "facility provider" can be considered.	• The proposed section 2A(6) (Clause 6 of the Bill) provides that an SVF may be in physical or electronic form. The use of the word "issuer" is in line with practices adopted in other major jurisdictions. • Under section 2 (Clause 5(11) of the Bill), "issue", in relation to an SVF, includes "the operation of the facility by the issuer for use by the user of the facility after its issue". As such, "issuer" means more than a "facility provider". We believe that the proposed term "issuer" is appropriate.
Single-purpose SVF	• The definition of "single-purpose SVF" should be limited to its usage for redemption of goods or services specified before storage of the value provided directly by the SVF issuer. • There should be a separate definition of	• The proposed definition is formulated with reference to the existing definition of "single-purpose card" under section 2 of the Banking Ordinance ("BO"), while the concept of "money's worth" is adopted from the "multi-purpose card" regime under the BO. We believe that the present formulation has so far

Category	Views	Government's Response
	"money's worth". • There should be a self-reporting mechanism for issuers of single-purpose SVF to report their documentation to HKMA so that HKMA may determine whether they amount to single-purpose SVF.	been operating effectively under the BO and is wide enough to serve its coverage in the Bill. • The proposed section 8B (Clause 17 of the Bill) provides that no person may issue, or facilitate the issue of, an SVF without a licence granted by the Monetary Authority ("MA"). It will be an offence to issue, or facilitate the issue of, an SVF without being authorized by a licence. In other words, an issuer who intends to expand its SVF business from a single-purpose usage to a multi-purpose one must apply for a licence in accordance with the proposed section 8E. After the passage of the Bill, the MA will monitor the market development, on an on-going basis, through surveillance to identify any unlicensed SVF operating in Hong Kong.
Definition of "facilitator"	• The definition of "facilitator" needs elaborations with examples.	• The definition of "facilitator" is applicable to the business model of certain "multi-purpose cards" schemes, which involved two distinct functions,

Category	Views	Government's Response
	• Requested clarification on whether banks would be "facilitators" when they offer facilities to enable customers to reload an SVF. • The supervisory regime for regulating facilitators should be extended to cover facilitators of a single-purpose SVF who operate the float of the SVF.	namely (a) origination of electronic value for storage in "multi-purpose cards", and (b) distribution of the "multi-purpose cards" to end-users. The two functions may be performed by different entities. • For example, under the Mondex Scheme (which is no longer in operation now), Mondex was the originator of value and held the pool of funds which backed the stored value in circulation but the Mondex cards were issued and distributed by member banks. "Facilitator" covers any person who provided value to an issuer of a "multi-purpose card" which determined the extent to which the issuer could provide its customers with electronic value. An originator such as Mondex, who creates electronic value and sells the value to a SVF issuer, would be regarded a "facilitator" under this definition (the proposed section 2B under Clause 7 of the Bill, as adopted from section 2(11) of the BO). A

Category	Views	Government's Response
		person who provides ancillary or support services to assist the issuer of the SVF, such as payment collection, a payment gateway, value reloading, and operational support, will not be considered a "facilitator". • Although the business model involving a facilitator in issuing SVF may not be common in the current market, we consider it prudent to retain the definition of "facilitator" in the Bill to ensure that the supervisory powers are in place if such a business model is adopted in Hong Kong. • In line with the existing "multi-purpose cards" regime under the BO, as well as practices adopted by other major jurisdictions, we propose that single-purpose SVF will remain not be subject to regulation. As such, we do not consider it necessary to regulate a facilitator of a single-purpose SVF.

Category	Views	Government's Response
Definition of "retail payment systems"	• Suggest deleting the reference to "principally by individuals". If there should be flexibility to exclude certain types of facility, the MA could be allowed to exempt certain class of payment systems from the definition of RPS. • Banks should be made outside the scope of regulation as "system operators" of RPS. However they should remain within the scope of "settlement institutions". It is not clear whether bill payment services and shared ATM networks involving third parties and/or their customers may be caught. We believe that this should not be the case because the services are still effectively provided by banks to their own customers.	• The reference to "principally by individuals" intends to differentiate an "RPS" from a large value "clearing and settlement system" (which serves financial institutions), and allows the former to capture a payment system which performs not only clearing or settlement functions, but also the transfer of payment obligations related to retail activities involving purchases or payments, principally by individuals. • The MA does not intend to designate a payment system operated by an authorized institution ("AI") and serving its own customers, including its internet and mobile banking payment services, electronic fund transfer services, bill payment services, ATM networks, etc., as these systems within the bank are already subject to the MA's prudential supervision under the BO. However, if an AI provides RPS services to other payment service providers, such RPS may be

Category	Views	Government's Response
		subject to designation if it falls within the proposed designation criteria. • After the passage of the Bill, the MA may issue guidelines to facilitate compliance with the Ordinance.
Grounds for designation	• The designation criteria in relation to "inefficiency" in a payment system giving rise to adverse impact on day-to-day commercial activities should be elaborated.	• The proposed section 4(3A) (Clause 10 of the Bill) provides that, if the presence of any significant inefficiency in the functioning of the system is likely to adversely affect day-to-day commercial activities, then the system's proper functioning is regarded as significant in terms of public interest. The MA may designate the system under section 4(1), having regard to the factors specified in the proposed section 4(4A). In general, the MA may take into account factors such as the overall impact on the smooth conducting of daily commercial activities; the population affected; and the extent of economic losses arising from the halt of the commercial

Category	Views	Government's Response
		activities, etc. This will involve a supervisory assessment of the factual circumstances of a particular system.
Deemed licensees	• It is not clear whether a deemed licence given to a bank includes a deemed licence as a facilitator.	• The proposed section 2 (Clause 5(11) of the Bill) provides that "licence" means a licence granted under section 8F or regarded as granted under section 8G. The proposed section 8G (Clause 17 of the Bill) provides that a bank is regarded as being granted a licence under section 8F. The proposed section 8F(1)(a) provides that the MA may grant a licence to authorize the issue of any SVF or the facilitation of the issue of any SVF. Banks are therefore deemed licensed to issue, or facilitate the issue of, SVF.
Usage of wholly-owned subsidiaries by banks	• Banks using a wholly-owned subsidiary to operate an SVF business should not be required to go through the licensing process given that the banking institution (including subsidiaries) comes within the MA's	• As a subsidiary of a licensed bank is a legal entity separate from the licensed bank per se, that subsidiary should be subject to the licensing requirements contained in the Bill if it is to issue SVF. The proposed arrangement is in line with

Category	Views	Government's Response
	supervision, and so a wholly-owned subsidiary should be deemed licensed also to issue SVF.	the regulation of securities and insurance business of an AI.
Conditions to licenses	• In view of the extensive powers of control over banks exercised by the MA under the BO, including section 16(5) and (9) of the BO which allows the imposing of conditions on banking licences and section 16(9)(aa), (ab) and (ac) of the BO in relation to stored value cards, we believe that the application of the proposed sections 8I and 8K (conditions to licences) should be limited to non-bank licensees.	• Given that an SVF business is distinct from banking services and to ensure a level playing level between bank and non-bank licensees, banks that engage in the SVF business shall comply with the proposed regulatory regime contained in the Bill which is specifically tailored for the regulation of SVF. Given the migration of the regulatory regime for "multi-purpose cards" in the BO to that for SVF under the Ordinance, the power of the MA to attach licence conditions under the Ordinance should apply to a SVF licence held by a bank or non-bank equally. Section 16(9)(aa), (ab) and (ac) of the BO will be consequentially repealed, as proposed in Clause 57(8) of the Bill.

Category	Views	Government's Response
Fees	• As banks already paid a licence fee under the BO, we do not think it is appropriate that they should be required to pay an additional licence fee to carry on an SVF business.	• To ensure a level playing field between banks and non-banks operating an SVF business, all SVF issuers so licensed shall pay a licence fee for their SVF business.
Float safeguarding requirements	• Section 7(c) of Part 2 of Schedule 3 of the Bill should not apply to bank licensees as banks are already subject to stringent capital and liquidity ratio rules under the BO. • Suggest further provisions on safeguarding of float and SVF deposit for non-bank licensees– (i) usage of a guaranteed fund or debt certificate; (ii) amending the insolvency regime to provide that in an insolvency the segregated float and SVF deposit will be available on a preferential basis first	• The primary objective of the proposed SVF regulatory framework is to ensure the safety and soundness of SVF issuers, as well as proper float protection and management. In respect of float protection (section 7 of Part 2 of Schedule 3), we propose that SVF issuers will need to demonstrate to the MA that they have put in place measures that will ensure on-going compliance with the following principles– (a) the float must be kept separate from the SVF licensee's other funds maintained or received by the company; and (b) the float must be adequately protected by safeguarding measures.

Category	Views	Government's Response
	to meet the claims of the users of the SVF.	• To ensure a level playing field, the above two principles should apply to both bank and non-bank licensees. The MA will discuss with each SVF licensee, whether it is a bank or a non-bank, its float safeguarding approach to ensure that the proposed measures will provide adequate protection to users and that the approach will suit the issuer's business operation and risks profile.
Reporting obligations	• The new section 8R proposed in Clause 17 of the Bill duplicates section 67 of the BO and should not apply to bank licensees. Some of the penalties in section 67 of the BO are different from those in the new section 8R. If section 8R is to remain, the fines should be brought into alignment.	• We will give this further consideration and, if necessary, propose committee stage amendments to exempt the application of the new section 8R to bank licensees.
Reporting material changes	• Paragraph (d) of new section 8T(1) should be made clearer.	• The proposed section 8T(1)(d) (Clause 17 of the Bill) has to be read in conjunction with the rest of the section. Section 8T(1) provides that an

Category	Views	Government's Response
		SVF licensee is required to report to the MA if there is, or is likely to be, a material change in the circumstances that is relevant to the licensee's ongoing fulfilment of any minimum licensing criteria, any licensing conditions and section 8O (the obligation to ensure the safety and efficiency of the SVF), as well as the ongoing issue or facilitation of the issue of SVF. These circumstances would have a bearing on the licensee's ability to continue the SVF business in question and may warrant supervisory responses by the MA in the interest of the users or potential users of the SVF.
Revocation or suspension of licences	• As the BO provides for revocation and suspension of a banking licence (see Parts V and VI), it seems that there is a case for not applying this provision to bank licensees on the basis that there are adequate powers contained in the BO and also the ability to attach conditions to a	• As explained above, given that SVF business is distinct from banking services, banks that engage in an SVF business would need to comply with the proposed regulatory regime contained in the Bill which is specifically tailored for the SVF business. It is therefore necessary to have in place a mechanism for the revocation and

Category	Views	Government's Response
	banking licence which give the MA the regulatory tools to exercise control over bank licensees.	suspension of an SVF licence, for a bank or non-bank licensee, in the Ordinance. Also, a revocation or suspension of the SVF licence held by a bank under the Ordinance does not automatically result in the revocation or suspension of a banking licence under the BO.
Transfer of deemed licence	• It should be made clear that a bank deemed a licensee may transfer its licence at the same time that it transfers its licence as a bank in accordance with the provisions of Part VII of the BO.	• The proposed section 8G(a) (Clause 17 of the Bill) provides that a bank is regarded as being granted a SVF licence under section 8F at the time when it is granted a banking licence. Thus, a deemed SVF licence under the Ordinance is transferred at the time when the banking licence is transferred under the BO.
Examination of books and transactions	• It seems that in the same way as bank SVF licensees are exempt from the requirement in respect of these sections, banks should be similarly exempt in their capacity as a system operator, settlement institution or participant.	• Under the existing section 12 of the Ordinance, a bank which is acting as a "settlement institution" of a clearing and settlement system is subject to the information gathering power to be exercised by the MA.

Category	Views	Government's Response
		• A bank is not deemed licensed to be a system operator, a settlement institution or a participant of a designated RPS. The proposed sections 12A and 12B (Clause 22 of the Bill) should be applied consistently to any settlement operator, settlement institution, or participant of a designated RPS, whether it is a bank or otherwise, to ensure a level playing field and effective supervision over relevant parties under the Ordinance.
Investigation	• The MA has extensive powers of investigation over banks under Part XX of the BO. Therefore, there is a case for exempting Part 3A from application to banks.	• As explained above, given that SVF business is distinct from banking services and to ensure a level playing field between banks and non-banks, banks that engage in an SVF business would need to comply with the proposed regulatory regime contained in the Bill which is specifically tailored for the SVF business. We consider that the proposed investigation powers of the MA are necessary to serve the regulatory purposes of the Ordinance consistently, insofar

Category	Views	Government's Response
		as banks and non-banks are concerned. The MA also holds separate investigation powers for banks under the Securities and Futures Ordinance ("SFO", Cap. 571) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance ("AMLO", Cap. 615).
Pecuniary penalty	• The proposed pecuniary penalty goes beyond the normal scope of regulatory sanctions, which would normally include the kind of remedies provided for in the section 33Q(2)(b) and (c) i.e. cautions, warnings, reprimands or requirement to take or refrain from taking particular action. The MA is exercising a form of extra judicial criminal sanction and it seems that this is a process which is more adequately handled by the Courts or a Tribunal and not apparently on a discretionary basis by a regulator.	• In devising the proposed regulatory regime, we have made reference to similar arrangements in the SFO and the AMLO, under which the MA is empowered to impose sanctions (including the proposed civil fine) on the regulatees if there is a contravention of the relevant provision of that Ordinance. We therefore consider the proposed pecuniary penalty appropriate. • The proposed section 33Q (Clause 29 of the Bill) provides that the MA may impose sanctions if the MA is satisfied that a person has contravened a provision of the Bill, a requirement under the

Category	Views	Government's Response
	• These provisions do not specify what the burden of proof should be and it seems to us that given the seriousness of the potential sanction, the burden should be a criminal one rather than a civil one.	Bill, or a condition attached to a licence. The section relates to the exercise of the civil disciplinary power of the MA as a regulator, as opposed to the criminal prosecution in relation to a contravention. The decision of the MA to impose a civil sanction under the proposed section 33Q is subject to review by the Payment Systems and Stored Value Facilities Appeals Tribunal ("the Tribunal").
Guidelines	• The consultation arrangement in section 54 should apply to all guidelines proposed to be issued and should include consultation with all stakeholders including SVF licensees.	• We consider that the MA should be empowered to issue guidelines in relation to the regulation of SVF in a timely manner, given users' float is involved. This arrangement is in line with the existing power of the MA to issue guidelines under the BO. That said, we will further review the proposed arrangement prescribed in the Bill, including the consultation process for the guidelines.

Category	Views	Government's Response
Anti-money laundering	• It seems that the policy intention is that the reference to exceeding the HK$3,000 figure should relate to each user. • The amendment to the AMLO does not provide a definition of a "physical device" based facility. For clarity this should be included so as to make it clear what falls outside the scope of Schedule 2 to the AMLO and in particular whether non-physical device based SVFs need to be linked to a bank account or credit card account.	• The reference to exceeding the HK$3,000 figure relates to each SVF issued by an issuer. • An SVF is device-based if it is in the form of a physical device provided by the issuer to the user and the stored value is stored on that device. See also the proposed section 8ZZZI(4)(a) and (b) (Clause 17 of the Bill) which describes a device-based and network-based facility.
Licensing of money services	• The proposed disapplication of the relevant Part of the AMLO in relation to the regulation of money service operators ("MSO") should be extended to a system operator and settlement institution in respect of a designated clearing and settlement system.	• Designated clearing and settlement systems are mainly responsible for the clearing and settlement of large value payment obligations or transfer of book-entry securities at the interbank level. Since participating banks of a designated clearing and settlement system are already subject to the AMLO and it is unlikely that a

Category	Views	Government's Response
		designated clearing and settlement system would involve provision of MSO services, we do not consider it necessary to extend the proposed disapplication to designated clearing and settlement systems.
Reviewable decisions	• The decisions to revoke a licence in respect of a SVF under section 8V(4), and to propose to suspend or to suspend a SVF licence under section 8ZA, should be included among the reviewable decisions for the Tribunal.	• The proposed section 8V(4) does not contain a decision of the MA but procedures which the MA must follow after serving a notice of proposal to revoke under the proposed section 8V(3), in relation to those matters provided in sections 8V(4)(a), (b) and (c). • The proposed Part 2 of Schedule 2 provides that a decision of the MA to suspend a licence under sections 8Z(1) or 8ZA(1), or renew the suspension under Section 8ZA(7), is a decision of the MA reviewable by the Tribunal.

Category	Views	Government's Response
Exempt facilities	• Section 8ZZZB(2) does not provide a definition of immateriality but some guidance to the MA's thinking can be obtained from section 8ZZZD(3) which sets out matters that the MA may consider to be relevant in relation to an application to provide a discretionary exemption for a SVF. A better approach might be for intended operators of exempted systems to be required to apply to the MA for confirmation of exemption.	• The exemption contained in Schedule 8 does not require prior application. In relation to the meaning of "immaterial" in section 8ZZZB(2), the MA may issue guidelines to facilitate compliance with the Ordinance after the passage of the Bill.
Other comments	• It may be necessary for the MA to regulate the number of accounts that may be established by one customer under a SVF issuer to avoid overstress of the issuers as a result of withdrawals from the SVF to achieve greater protection especially in the event of a market downturn. If there are such limits, the MA could issue guidance on how to enforce the limits. Anonymously	• The proposed section 10 of Part 2 of Schedule 3 (Clause 53 of the Bill) provides that an SVF licensee must satisfy the MA that the SVF scheme is prudent and sound, having regard to the purpose, business model and operational arrangement of the scheme, and that the scheme must be operated prudently and with competence in a manner that will not adversely affect, among others, the interests of the user or potential user

Category	Views	Government's Response
	operated systems should justify a lower limit in relation to the number of accounts held by a customer. • In respect of banks, there should be a negative disclosure requirement covering the fact that users are not protected by the deposit protection scheme. • Internet banking transactions operated by both bank and non-bank SVF issuers should have transaction limits in line with the existing policies, procedures and controls.	of the SVF. In considering whether an SVF issuer meets the above licensing criteria, the MA will take into account the ability of SVF to meet the redemption request, particularly in the event of a market downturn. The MA may issue a guideline to further outline its regulatory approaches. • HKAB's suggestion on the negative disclosure requirement is noted. We will discuss with the Hong Kong Deposit Protection Board whether the proposed disclosure requirement is necessary for banks' customers with reference to comparable practices currently in force. • Section 5 of Part 2 of Schedule 3 provides that the SVF licensees must have in place appropriate risk management policies and procedures for managing the risks arising from the operation of its SVF scheme that are commensurate with the scale and complexity of the scheme, including

Category	Views	Government's Response
		effective means to detect fraud and attempted fraud, and other operational and security safeguards appropriate for the scheme.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
April 2015