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2 April 2015

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Bills Committee on Clearing and Settlement Systems (Amendment) Bill 2015
Legislative Council
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Sirs

Clearing and Settlement Systems (Amendment) Bill 2015

We are writing to set out our comments on the above Bill.

Generally, we support the policy intent of the Bill but believe that refinements are necessary in a number of areas. These are set out in our detailed comments below and we also provide a brief Executive Summary of these.

For clarity, references to Section numbers are to the Sections of the Ordinance as proposed to be amended by the Bill.

A. **EXECUTIVE SUMMARY**

Banks as Deemed Licensees

Our members are all banks licensed and regulated under the Banking Ordinance and as such are deemed licensees in respect of stored value facilities and are not subject to a number of the regulatory provisions of the Bill. There are however regulatory provisions of the Bill which will apply to them. We think that this is undesirable and unnecessary given the provisions of the Banking Ordinance which apply to them. This is a running theme to many of our comments on: Licensing of Facilitators, Wholly-Owned Subsidiaries of Banks as Deemed Licensees, Conditions to Licences, Fees, Separation of Float, Reporting Obligations, Examination, Revocation and Suspension of Licences, Transfer of Licences and Investigations.

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Vice Chairmen Bank of China (Hong Kong) Ltd
Standard Chartered Bank (Hong Kong) Ltd
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秘書 陳崇禧



Definitional Provisions

Comments are made on the principal definitions used in the Bill which define the scope of regulation.

Pecuniary Penalties

The provision enabling the HKMA to levy a penalty of up to the greater of HK\$10,000,000 or three times the greater of profit made or loss avoided should be revised so that the sanction is made by a Court or Tribunal.

Guidelines

Guidelines issued by the HKMA should be subject to prior industry consultation.

Anti-Money Laundering

Revisions are suggested to the revisions to the money laundering legislation.

Appeal Tribunal

The Payment Systems and Stored Value Facilities Appeals Tribunal should be able to review decisions to revoke or suspend a licence.

Exemptions

There should be a mechanism for determining with greater clarity the availability of exemptions.

Additional Comments

Additional comments are made on matters which arose during the consultation process but which are not included within the Bill.

B. DETAILED COMMENTS

Section 2 Definitions of "system operator" and "settlement institution"

There seems to be some overlap in the definitions of "system operator" and "settlement institution" in that both of them involve providing settlement functions. We believe that the settlement functions of the settlement institution should be more appropriately described in a similar way to that set out in the definition of "settlement institution" in the existing Clearing and Settlement Systems Ordinance so that it involves the provision of settlement accounts to the participants in the facility and any central counterparty.

The same issue arises in relation to the application of the definitions to a clearing and settlement system.



Section 2A(1) Definition of "stored value facility"

The definition and other relevant provisions on which we do not separately comment use the word "issuer". Whilst this is appropriate in relation to a card-based facility, it may not be an appropriate usage for a facility which is not card-based. We think it would be worth considering revising this terminology to something along the lines of "facility provider".

Section 2A(5) Definition of "single purpose stored value facility"

An improvement to the definition of single purpose stored value facility would be that it should be limited to usage for redemption of goods or services specified before storage of the value provided directly by the issuer of the stored value facility. Also, we believe for clarity of this definition, there should be a separate definition of "moneys worth".

In respect of single purpose stored value facilities, we consider that there should be a self-reporting mechanism for issuers' single purpose stored value facilities to report their documentation to HKMA so that HKMA may determine whether they amount to single purpose stored value facilities.

Section 2B Definition of "facilitator"

This is not clear and we believe needs revisiting and perhaps elaborated with examples. In particular, it describes the creation of electronic value as being "the value of which determines, whether in whole or in part, the extent to which the issuer may provide any undertaking ...". We think that clearer wording would be "for the purpose in whole or in part of satisfying any undertaking ...".

Another issue is whether when banks offer facilities to enable customers to reload stored value facilities, they would be considered to be facilitators. We believe this is not the policy intent and should be excluded from the scope of the definition.

We also consider that the supervisory regime for regulating facilitators should extend to cover facilitators of single purpose stored value facilities who operate the float of the single purpose stored value facilities.

Section 2B Definition of "retail payment systems"

The definition of "retail payment system" is limited to retail activities and those carried on principally by individuals. This introduces a level of uncertainty as to the application of the definition and we would suggest that reference should simply be made to activities involving purchases or payments and delete reference to "principally by individuals". If there is a desire to allow flexibility to exclude certain types of facility, perhaps the same approach could be made by including within the definition the ability of the HKMA to declare a particular class of



payment system as being excluded in the same way as is the case in the definition of “multi-purpose card” in the Banking Ordinance. This could also accommodate the policy intention not to include other ancillary service providers such as computer system operators and telecommunication network facilities.

In the same way as banks are deemed licensees of stored value facilities, perhaps a case can be made for them to fall outside the scope of regulation as system operators of retail payment systems. They should however be within the scope of regulation in their capacity as settlement institutions.

Under the earlier Consultation Paper, it is stated that the HKMA’s policy intention is not to cover retail payment systems operated by authorized institutions, such as internet and mobile banking services, card mobile payment or ATM networks, covering their own customers. This is not clear from the definition. It was however also mentioned in the Consultation Paper that, where the authorized institutions provide retail payment systems to other service providers, they may still be subject to designation. It is not clear whether bill payment services and shared ATM networks involving third parties and/or their customers may therefore still be caught. We believe that this should not be the case because, even though they may involve third parties, the services are still effectively being provided by banks to their own customers.

Section 4(3A)(c) Grounds for Designation

This is a new provision which defines matters of significant public interest for the purpose of designating a payment system and states that this will be triggered if an inefficiency arises which is likely to adversely affect day-to-day commercial activities. It seems to us that this is too vague and should be elaborated. As drafted, this is of uncertain meaning and too subjective.

Sections 8F and G Deemed Licensees

It is not clear whether the deemed licence given to banks includes a deemed licence as a facilitator. Section 8F provides for granting of a licence to issue a stored value facility or to facilitate the issue of a stored value facility (i.e. it contemplates two possible licences). However, Section 8G simply states that a bank is regarded as being granted a licence under Section 8F. We believe banks should be deemed licensees as facilitators.

Section 8G Usage of Wholly-Owned Subsidiaries by Banks

It seems that if banks wish to use a wholly-owned subsidiary to operate a stored value facility they will be required to go through the licensing process. We do not consider that this is appropriate given that the overall banking organization (including subsidiaries) comes within HKMA supervision and so wholly-owned subsidiaries should be deemed licensed also.



Sections 8I and 8K Conditions to Licences

These sections entitle the HKMA to attach conditions to licences in respect of stored value facilities including those deemed granted to banks. Whilst it is clearly appropriate for the HKMA to be able to attach conditions to the licence of a non-bank licensee, in view of the very extensive powers of control over banks exercised by the HKMA under the Banking Ordinance, we believe that the provisions should be limited in their application to non-bank licensees. See Section 16(5) and (9) of the Banking Ordinance which allows the imposing of conditions on banking licences including in Section 16(9)(aa), (ab) and (ac) specific provisions regarding stored value facilities. Sections 16(9)(aa), (ab) and (ac) are proposed to be repealed in the Bill but it seems to us that the proper place for regulating bank licensees is the Banking Ordinance and that the existing provisions in the Banking Ordinance entitling the HKMA to impose conditions on banking licences together with specific condition enabling provisions in respect of stored value facilities are the proper place of regulating bank licensees.

Section 8N Fees

As banks already pay a substantial licence fee under the Banking Ordinance, we do not think it is appropriate that they should be required to pay an additional licence fee to carry on on an exempted basis this type of business.

Section 8Q, Schedule 3, Paragraph 7

Section 8Q applies to both bank and non-bank licensees and requires them to comply with the minimum criteria set out in Schedule 3. Several of the provisions of Schedule 3 do not apply to bank licensees but some of them do. Whilst those that do, those relating to knowledge and experience, prudential and risk management, anti-money laundering and counter-terrorism measures, redemption of outstanding stored value, operating rules and purpose and soundness of the relevant scheme do not seem to be unreasonable. Paragraph 7 however provides for management of the float and SVF deposit and this requires licensees to have adequate risk management policies for managing the float or SVF deposit and implement those policies. It goes on to say that the float or SVF deposit must be kept separate from any other funds paid or received by the licensee and is adequately protected by measures for protecting the float or SVF deposit. This will require banks to segregate the float or SVF deposit and we query why this is necessary for banks which are already subject to stringent capital and liquidity ratio rules under the Banking Ordinance. It is fair to say that as the Banking Ordinance now stands authorized institutions as licensees of stored value facilities are not required to maintain this separation although they may be required to do this by conditions imposed under Section 16(9)(aa), (ab) and (ac). It is understood that these requirements are ones which are applied exceptionally and not as a matter of course. We therefore suggest that paragraph 7(c) of Schedule 3 of the Bill should be expressed so that it does not apply to bank licensees.



In respect of non-bank licensees, we believe that there should be further provisions for safeguarding the float and SVF deposit.

We consider the following possibilities might be considered:-

- (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 to meet the claims of the users of the SVF.

Section 8R Reporting Obligations

This applies to bank licensees and non-bank licensees and requires them to notify the HKMA of their inability to meet obligations or to suspend payments. Insofar as bank licensees are concerned, this duplicates Section 67 of the Banking Ordinance. We therefore suggest that this should not apply to bank licensees. We also note that some of the penalties in Section 67 of the Banking Ordinance are different from those in Section 8R. If this section is to remain, the fines should be brought into alignment.

Section 8T(1)(d) Reporting Material Changes

This requires both bank and non-bank licensees to advise the HKMA of any material changes in respect of various circumstances. Paragraph (d) states that the relevant material of changes apply to "the ongoing issue or facilitation of the issue of stored value facilities by the licensee". This, it seems to us, is unnecessarily vague and should be made clearer.

Part 2A, Division 5 Revocation or Suspension of Licence

This division applies to both bank and non-bank licensees and provides for the ability of the HKMA to revoke or suspend a licence. It is clear that a licence granted to a bank licensee would be revoked or suspended in the event that their banking licence under the Banking Ordinance is revoked or suspended. This is clearly appropriate. The division, however, goes on to provide further grounds for revocation of the deemed licence granted to a bank licensee. As the Banking Ordinance already provides for revocation and suspension of a banking licence (see Parts V and VI), it seems to us that there is a case for not applying this provision to bank licensees on the basis that there are adequate powers contained in the Banking Ordinance and also the ability to attach conditions to a banking licence which give the HKMA the necessary regulatory tools to exercise control over bank licensees. Note in particular the criteria for revoking the licence which are set out in Schedule 5 and these include inter alia non-compliance with minimum criteria set out in Schedule 3 (see above).



Part 2A, Division 7 Transfer of Deemed Licence

In respect of banks, it should be made clear that a bank as a deemed licensee may transfer its deemed licence at the same time that it transfers its licence as a bank in accordance with the provisions of Part VII of the Banking Ordinance.

Sections 12A and 12B Examination of Books and Transactions

These sections entitle the HKMA to examine books of account and transactions as well as to require the preparation of a report by auditors for specified persons. For the purpose of these sections specified persons include system operators, settlement institutions, participants and licensees but in respect of licensees, they only apply to non-bank licensees. It seems to us that in the same way as bank licensees are exempted from the requirement in respect of these sections on licensees, they should be similarly exempted in their capacity as a system operator, settlement institution or participant (see also Section 63 of the Banking Ordinance which in relation to banks covers similar ground).

Part 3A Investigations

This part is a new part of the Ordinance which relates to investigations by the HKMA. It applies generally to system operators, settlement institutions and participants and licensees and would include any of these entities who are also banks. The HKMA already has extensive powers of investigation over banks under Part XX of the Banking Ordinance and insofar as these provisions are considered to be adequate under that Ordinance it would not seem to be necessary to impose further investigatory provisions over banks in their capacities as system operators, settlement institutions, participants or licensees. Also, there would be obvious difficulties if investigations were ordered under both the Banking Ordinance and under this Ordinance and so we believe there is a case for exempting Part 3A from application to banks on the basis that investigations into banks are already adequately covered by Part XX of the Banking Ordinance.

Section 33Q(2)(a) Pecuniary Penalty

This section which applies to regulated persons including a system operator, settlement institution, participant or licensee whether a bank or a non-bank and enables the HKMA if it is satisfied that the relevant person has breached the Ordinance, a requirement imposed under the Ordinance or a condition attached to a licence to impose a pecuniary penalty which is up to the greater of HK\$10 million or three times the amount of the profit gained or loss avoided by the person as a result of the contravention. This clearly goes beyond the normal scope of regulatory sanctions which would normally include the kind of remedies provided for in Section 33Q(2)(b) and (c) i.e. cautions, warnings, reprimands or requirement to take or refrain from taking particular action. Insofar as the proposed pecuniary penalties are concerned, the HKMA is effectively exercising a form of extra judicial criminal sanction and it seems to us 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. This would enable the defendant to have the benefit of the necessary procedural protections applicable in respect of criminal prosecutions and an ability to defend itself properly e.g. to cross-examine witnesses and to test the evidence relied upon and then for an independent person (i.e. a judge) to make a judgment based on the merits of the case. As it is, the HKMA lacks independence because it is exercising both a prosecutorial and judicial function. A related issue is that 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 i.e. "beyond the reasonable doubt" rather than a civil one, "on balance of probability".

Section 54(1) and (1A) Guidelines

The sections contain revised provisions entitling the HKMA to issue Guidelines. The section which they replaced contains a requirement to consult with system operators and settlement institutions of designated system. Now, the Guidelines are much wider but the obligation to consult only applies to Guidelines issued under Section 54(1) and not under any of the other enabling provisions under the section neither does it apply to Guidelines related to stored value facilities. Consistent with other regulatory enabling provisions of this type, we believe that the consultation obligation should apply to all of the Guidelines proposed to be issued and should include consultation with all stakeholders including licensees of stored value facilities.

Clause 64 Anti-Money Laundering

The amendments to the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance disapply Schedule 2 to that Ordinance which will only apply if the maximum value that can be stored on a facility exceeds HK\$3,000 and the facility is in the form of a physical device and the value is stored on the device. As drafted, this section seems to contemplate that the maximum value amount is an aggregate amount for the whole facility in which case the intended exclusion would be derisory. It seems to us that the policy intention is that the reference to exceeding the HK\$3,000 figure should relate to each user. The amendment to the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance does not provide a definition of a "physical device" based facility and for clarity we believe this should be included so as to make it clear what falls outside the scope of Schedule 2 and in particular whether non-physical device based SVFs need to be linked to a bank account or credit card account.

Clause 66 Licensing of Money Services

Amendment to Section 25 of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance - This section disapplies the licensing system in respect of money services to an SVF licensee or a system operator or settlement institution of a designated retail payment system where the money services ancillary to the licensee's principal business or the business at a system



operator or settlement institution. It seems to us that this disapplication should also extend to a system operator and settlement institution in respect of a designated clearing and settlement system.

Schedule I, Part 2 Reviewable Decisions

This part sets out the decisions which may be reviewed by the Payment Systems and Stored Value Facilities Appeals Tribunal. Generally, this includes the decisions which were previously subject to review and new matters which are appropriate to review based on the revisions to the Ordinance. However, omitted are decisions to revoke a licence in respect of a stored value facility under Section 8V(4) or a decision to propose to suspend or to suspend a licence in respect of a stored value facility under Section 8ZA. We believe that these should be included among the reviewable decisions.

Schedule 8 Exempt Facilities

These set out certain types of facilities which are exempt from regulation and include cash award schemes, schemes for purchasing digital products, bonus points scheme and schemes for use within limited premises. An overarching requirement for the exemption is that the issuer of the relevant stored value facility must provide the HKMA with information necessary to satisfy it that the risks posed by the facility to the user or financial system in Hong Kong are immaterial (see Section 8ZZZB(2)). This section does not provide a definition of immateriality but some guidance to the HKMA thinking can be obtained from Section 8ZZZD(3) which sets out matters that the HKMA may consider to be relevant in relation to an application to provide a discretionary exemption for a stored value facility. Perhaps a better approach might be for intended operators of exempted systems to be required to apply to the HKMA for confirmation of exemption.

Additional Comments

It may be necessary for HKMA to regulate the number of accounts that may be established by one customer under a stored value facility issuer to avoid overstress of stored value issuers as a result of withdrawals from the stored value facility to achieve greater protection especially in the event of a downturn in the market.

No clear proposals are made in respect of limits and, it seems, subject to negotiation. It is unclear how this would apply to banks as the limitations are given effect to by attaching a condition on the licence. It might be helpful if the HKMA could issue some clearer guidance as to how it will exercise its discretion and how (if at all) this will apply to banks.

We think that a major factor to be considered in relation to the setting of a limit should be whether or not the SVF facility is offered on an anonymous basis. Clearly, anonymously operated systems do have their own risks as well as AML considerations. These would justify a lower limit.



Also, where the SVF issuer is a bank in view of the higher regulatory requirement under which it operates, a higher limit might be justified.

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 existing policies procedures and controls.

We hope you will find this to be helpful.

If you have any questions, please address them to the undersigned.

Yours faithfully

A handwritten signature in black ink, appearing to be "Henry Chan", written in a cursive style.

Henry Chan
Secretary