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**Paper for the House Committee Meeting
on 6 February 2015**

**Legal Service Division Report on
Clearing and Settlement Systems (Amendment) Bill 2015**

I. SUMMARY

- 1. The Bill**

The Bill seeks to amend the Clearing and Settlement Systems Ordinance (Cap. 584) to:

 - empower the Monetary Authority (MA) to designate and oversee certain retail payment systems (RPSs);
 - set up a licensing regime to regulate matters relating to the issue of certain stored value facilities (SVFs) and provide that it would be an offence to issue such SVFs without a licence from MA; and
 - provide for an investigatory regime and the power to impose sanctions by MA regarding contraventions of Cap. 584.

- 2. Public Consultation**

According to the LegCo Brief, the Administration launched a three-month public consultation on the proposed regulatory regime for SVFs and RPSs in May 2013. Comments received from respondents indicated overall support for the policy objectives and the key proposals.

- 3. Consultation with LegCo Panel**

The Panel on Financial Affairs was consulted on 7 April 2014 and members supported the proposed regulatory regime in principle.

- 4. Conclusion**

Since the Bill is likely to have important implications on 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.

II. REPORT

The date of First Reading of the Bill is 4 February 2015. Members may refer to the LegCo Brief (File Ref: B&M/2/1/20C) issued by the Financial Services and the Treasury Bureau on 21 January 2015 for further details.

Object of the Bill

2. The Bill seeks to amend the Clearing and Settlement Systems Ordinance (Cap. 584) to empower the Monetary Authority (MA) to designate and oversee certain retail payment systems (RPSs), to set up a licensing regime for issuing certain stored value facilities (SVFs), to provide for an investigatory regime and the power to impose sanctions by MA regarding contraventions of Cap. 584, and to make related amendments to other Ordinances.

Background

3. At present, the regulatory regime for stored valued cards only applies to device-based multi-purpose stored value products. Under section 14A of the Banking Ordinance (Cap. 155), only authorized institutions are permitted to issue a multi-purpose card or facilitate the issue of a multi-purpose card which is a stored value card¹ other than a single-purpose card. On the other hand, Cap. 584 provides for a statutory regime under which MA is empowered to oversee certain clearing and settlement systems for funds and securities in Hong Kong and also provides for finality in relation to the transactions effected through such systems.

4. According to paragraphs 2 and 3 of the LegCo Brief, in Hong Kong, due to technological advancements certain non-device-based SVFs have been offered to the public in recent years. Such facilities are normally issued outside the banking sector and stored value on network-based accounts, mobile network accounts or computer servers. The existing regulatory regimes under Cap. 155 and Cap. 584 do not cover a range of the non-device-based SVFs which are

¹ According to section 2(1) of Cap. 155, "stored value card" means a card (or like thing) on which data may be stored (or otherwise recorded) in electronic, magnetic or optical form and for or in relation to which a person pays a sum of money to the issuer of the card, whether directly or indirectly, in exchange for-

- (a) the storage of the value of that money, whether in whole or in part, on the card; and
- (b) either -
 - (i) an undertaking (whether express or implied) by the issuer that, on the production of the card to the issuer, and whether or not some other action is also required, the issuer will supply goods or services (which shall not include money or money's worth); or
 - (ii) an undertaking (whether express or implied) by the issuer that, on the production of the card to the issuer or a third party, and whether or not some other action is also required, the issuer or the third party, as the case may be, will supply goods or services (which may include money or money's worth); (Added 4 of 1997 s. 3).

primarily issued otherwise than by authorized institutions, as well as payment systems related to retail activities. According to the Administration, it is necessary to introduce a new regulatory regime to ensure the safety and soundness of SVFs (whether they are device-based or not) and RPSs insofar as they relate to the financial stability of Hong Kong.

Provisions of the Bill

5. The main features of the proposed regulatory regime and the major provisions of the Bill are summarized below.

Amendments to long title and short title of Cap. 584

6. Clause 3 of the Bill amends the long title of Cap. 584 to reflect the new scope of the Ordinance. Clause 4 changes the short title of Cap. 584 to "Payment Systems and Stored Value Facilities Ordinance".

Licensing regime for SVFs

Licence for the issue of SVFs

7. Clause 17 of the Bill adds a new Part 2A to Cap. 584 to provide for a licensing regime for SVFs². Under Division 2 of the new Part 2A, a person must not issue a SVF or facilitate the issue or knowingly promote the issue (including assisting in facilitating the issue) of a SVF unless the issue of the SVF is authorized by a licence issued by MA under Cap. 584. Any person who contravenes such requirement commits an offence. The maximum penalty for the offence is a fine of \$1,000,000 and imprisonment for five years on conviction on indictment, or a fine at level 6 (i.e. 100,000) and imprisonment for six months on summary conviction.

8. An application for a licence for the issue of a SVF may be made to MA in accordance with Division 3 of the new Part 2A. Under the new section 8G of Cap. 584, a bank holding a valid banking licence under Cap. 155 would be regarded as being granted a licence for issuing a SVF (subject to payment of the licence fee specified in the new Schedule 4).

² According to new section 2A(1) of Cap. 584, a facility is a "stored value facility" if -

- (a) the facility may be used for storing the value of an amount of money that (i) is paid into the facility from time to time; and (ii) may be stored on the facility under the rules of the facility; and
- (b) the facility may be used for either or both of the following purposes - (i) as a means of making payments for goods or services under an undertaking given by the issuer that if the facility is used as a means of making payments for goods or services, the issuer will accept the payments up to the amount of the stored value that is available for use under the rules of the facility; (ii) as a means of making payments to another person under an undertaking given by the issuer that if the facility is used as a means of making payments to another person, the issuer will make the payments to that person up to the amount of the stored value that is available for use under the rules of the facility.

Licensing criteria

9. Under the new section 8F(3) of Cap. 584, MA may grant the licence to the applicant (which must be a company) only if MA is satisfied that all the applicable minimum criteria are fulfilled by the applicant. The minimum criteria are set out in Part 2 of the new Schedule 3 to Cap. 584. Details are summarized as follows:

- (a) the principal business of the applicant must be the issue (or the facilitation of the issue) of SVFs (section 1 of Part 2 of Schedule 3);
- (b) the applicant must have adequate financial resources (whether actual or contingent) for operating its SVF scheme in the form of the applicant's paid-up share capital which is not less than \$25,000,000 (or an equivalent amount in any other currency that is freely convertible into Hong Kong dollars) (section 2 of Part 2 of Schedule 3);
- (c) the applicant has in place adequate risk management policies and procedures for managing the float³ or deposit to ensure that there will always be sufficient funds for the redemption of the stored value that remains on the SVF and the applicant must ensure that the float or deposit is at all time kept separate from any other funds paid to, maintained or received by the applicant (section 7 of Part 2 of Schedule 3);
- (d) each chief executive, director or controller⁴ of the applicant must be a fit and proper person to hold the position concerned and the applicant must always keep MA informed of the identity of each controller of the applicant (section 3 of Part 2 of Schedule 3); and
- (e) the applicant has in place adequate and appropriate systems of control for preventing or combating possible money laundering or terrorist financing (section 6 of Part 2 of Schedule 3).

Exemption to certain SVFs

10. Division 8 of the new Part 2A to Cap. 584 proposes that certain SVFs would be exempt from the licensing requirements under that Part, but MA may require the issuer or facilitator of an exempted SVF to provide MA with certain

³ Under the amended section 2 of Cap. 584, "float" means the stored value remaining on the relevant SVF but does not include any SVF deposit placed with the issuer of the SVF, or another person on behalf of the issuer, for enabling the SVF to be used.

⁴ Under the new section 8ZZE of Cap. 584, "controller" means - (a) a majority shareholder controller; (b) a minority shareholder controller; or (c) an indirect controller.

information that MA considers necessary for the assessment of the risks posed by such SVF to its users or potential users or to the payment or financial system of Hong Kong. The major types of SVFs specified in the new Schedule 8 (mostly single-purpose SVFs) include SVFs for certain cash reward schemes, SVFs for certain bonus point schemes, SVFs used within a limited group of goods or services providers, and SVFs used only within certain premises. Under the new section 8ZZZD, MA may also exempt a SVF from the relevant provisions of the new Part 2A by notice published in the Gazette. Such notice would not be subsidiary legislation subject to amendment by the Legislative Council .

Regulatory powers of MA over SVFs licensees

11. Under Division 3 of the new Part 2A to Cap. 584, MA may attach conditions to a licence that MA considers appropriate (including attachment of new conditions to an existing licence). Those conditions may include restrictions on the business of issuing or facilitating the issue of SVFs that may be carried on by the licensee or requirements for the administration, maintenance, management, use and regulation of the float or deposit of any SVF.

12. Under Division 5 of the new Part 2A, MA may revoke or suspend a licence if MA is satisfied that a ground for revoking a licence specified in the new Schedule 5 exists. Such grounds include, among others, insolvency or winding up of the licensee, the likelihood that the licensee would become unable to meet its obligations or is about to suspend payment, providing false or misleading information to MA, contravention of a condition of the licence, cessation to carry on the business of issuing or facilitating the issue of the SVFs, and failing to pay licence fees or any penalty as required by Cap. 584.

13. Under Division 6 of the new Part 2A, MA may, after consulting the Financial Secretary, exercise certain powers in the circumstances specified in the new section 8ZE. Those powers include requiring a licensee to take immediate action relating to its affairs, business or property that MA considers necessary, giving directions to a licensee to seek advice on the management of its affairs, business or property, and to appoint a manager to manage the licensee's affairs, business or property in the terms specified by MA. The powers of such a manager are specified in the new Schedule 7.

14. Furthermore, under the amended section 54 of Cap. 584, MA may issue guidelines to set out the manner in which MA proposes to discharge any duty or exercise any powers conferred on it under Cap. 584 in respect of SVFs, including issuing guidelines to assist issuers or facilitators of SVFs to comply with the relevant provisions of Cap. 584, as amended by the Bill.

Regulatory regime for RPS

15. Under the existing section 4 of Cap. 584, MA may designate any clearing and settlement system to be subject to the oversight of MA if MA is of the

opinion that 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 material to the functioning of Hong Kong as an international financial centre. The Bill seeks to amend section 4 of Cap. 584 to empower MA to also designate RPSs⁵. Furthermore, a new designation criterion is proposed for both clearing and settlement systems and RPSs so that MA may designate such a system if, having regard to matters of significant public interest, MA is of the opinion that the system should be so designated.

16. Under the new section 4(4B), MA may, in the notice published in the Gazette for the designation of a RPS, declare the activities that are allowed to be carried out through the designated RPS (the declared activities). Under the new section 6A, it would be an offence if an operator of a designated RPS, without MA's written consent, carries out through the RPS an activity that is not among the declared activities. The maximum penalty for the offence is a fine of \$400,000 and imprisonment for two years on conviction on indictment, or a fine at level 6 (i.e. 100,000) and imprisonment for six months on summary conviction.

17. The Bill also seeks to amend sections 6 to 8 of Cap. 584 relating to obligations of designated clearing and settlement systems to extend the application of those provisions to RPSs and to strengthen MA's oversight of designated RPSs and clearing and settlement systems (designated systems) by placing more emphasis on the risk management and control procedures relating to the operation of the designated systems, including financial soundness.

MA's investigatory powers and power to impose civil sanctions

18. Clause 29 of the Bill adds new Part 3A and Part 3B which respectively empower MA to (a) conduct investigations into SVF licensees and designated systems; and (b) impose civil sanctions on specified regulated persons.

19. Under section 33B of the new Part 3A, MA may appoint certain persons (investigators) to conduct an investigation into an alleged contravention of a provision under Cap. 584, a requirement imposed under Cap. 584 or a condition attached to a licence or any other instrument granted or given by MA. Under the new section 33C, the investigators appointed by MA have the powers to require the relevant persons to produce documents or records relevant to the investigation and to attend before the investigators and answer questions relating to a matter under investigation. Failure to comply with such requirement would be an offence punishable by a fine of \$200,000 and imprisonment for one year on conviction on indictment or a fine at level 5 (\$50,000) and imprisonment for six months on summary conviction.

⁵ Under the amended section 2 of Cap. 584, "retail payment system" means a system or arrangement for the transfer, clearing or settlement of payment obligations relating to retail activities, principally by individuals, that involve purchases or payments, and includes related instruments and procedures.

20. Under section 33Q of the new Part 3B to Cap. 584, MA may, by notice in writing, impose one or more of the sanctions specified in that section against a regulated person, if MA is satisfied that the person has contravened a provision of or a requirement imposed under Cap. 584 or has contravened a condition attached to a licence, or any other instrument granted or given by MA under Cap. 584. The civil sanctions that may be imposed by MA include a pecuniary penalty not exceeding \$10,000,000 or three times the amount of profit gained or loss avoided as a result of the contravention (whichever is the greater), a caution, warning, reprimand, an order to take specified action(s) or the temporary suspension of a licence.

Revised ambit and name of the Clearing and Settlement Systems Appeals Tribunal

21. The existing Part 4 of Cap. 584 deals with matters relating to the review of the decisions made under the Ordinance and the functions of the Clearing and Settlement Systems Appeals Tribunal (CSSA Tribunal). The Bill seeks to amend Part 4 so that the list of reviewable decisions that are subject to review by the CSSA Tribunal is revised to cover all the relevant decisions made in relation to the regulatory regime for RPSs and the licensing regime for SVFs. The name of the Tribunal is also proposed to be amended to the Payment Systems and Stored Value Facilities Appeals Tribunal under clause 31.

Transitional arrangements

22. A new Schedule 9 is proposed to be added to Cap. 584 to set out the savings and transitional arrangements for the existing CSSA Tribunal (e.g. office of the existing Chairman and Tribunal members) and certain Gazette notices published under the existing provisions of Cap. 584.

Consequential and related amendments to other Ordinances

23. Part 3 of the Bill contains consequential and related amendments to Cap. 155 (e.g. repealing the existing section 14A of Cap. 155), the Electronic Transactions Ordinance (Cap. 553) and the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615).

Commencement

24. Except the provisions relating to the offences or enforcement provisions under the licensing regime for SVFs (i.e. the new sections 8B, 8C, 8D, 8G, 8U, 8Y and 8ZZZI of Cap. 584, and the relevant amendments to Cap. 155 and Cap. 615) (the remaining provisions), the Bill, if passed, would come into operation on the day on which it is published in the Gazette. The remaining provisions of the Bill will come into operation on the expiry of one year beginning on the day on which the enacted Ordinance is published in the Gazette. According

to paragraph 18 of the LegCo Brief, this phased implementation arrangement is intended to cater for the time required for potential and existing SVFs issuers to apply for a licence, as well as for MA to process the SVFs licence applications.

Public Consultation

25. According to paragraph 23 of the LegCo Brief, the Administration launched a three-month public consultation on the proposed regulatory regime in May 2013. Comments received indicated overall support for the policy objectives and the key proposals. Most respondents generally consider that a well-regulated environment will help further develop retail payment products and services in Hong Kong, and enhance users' acceptance of and confidence in such products and services. The Administration took on board certain suggestions and comments, after balancing relevant perspectives (e.g. market development, protection for users, and level-playing field considerations), and in contemplating the Bill, particularly in respect of the coverage of the regulatory regime, the licensing criteria and conditions, as well as the relevant transitional arrangements. A Consultation Conclusion was issued by the Administration in October 2014.

Consultation with LegCo Panel

26. The Clerk to the Panel on Financial Affairs has advised that the Panel was consulted on the proposal to establish a regulatory regime for SVFs and RPSs in Hong Kong on 7 April 2014, and members supported the proposal in principle. Members made enquiries on issues including supervision of SVFs issuers soliciting Hong Kong users without maintaining a local presence, capital requirement for SVFs issuers, regulatory treatment for single-purpose SVFs, and protection of personal data collected by SVFs issuers.

Conclusion

27. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. Since the Bill is likely to have important implications on 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.

Prepared by

YICK Wing-kin
Assistant Legal Adviser
Legislative Council Secretariat
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