

The Proposed Regulatory Regime for Stored Value Facilities and Retail Payment Systems in Hong Kong

Consultation Paper

Financial Services and the Treasury Bureau
www.fstb.gov.hk

Hong Kong Monetary Authority
www.hkma.gov.hk

May 2013

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Foreword

1. This consultation paper is jointly issued by the Financial Services and the Treasury Bureau (FSTB) and the Hong Kong Monetary Authority (HKMA) to seek views and comments on the proposed new regulatory framework for SVF and RPS in Hong Kong.

2. Prior to this public consultation, the HKMA conducted an industry consultation covering over 40 industry players and payment service providers between December 2012 and January 2013. In general, they indicated their support to the proposed regulatory framework for SVF and RPS and believed that the proposed framework would help further develop the payment industry in Hong Kong.

3. We expect to complete the whole public consultation process in the second half of 2013 and aim to introduce an amendment bill into the Legislative Council after considering the views and comments received from the public consultation.

4. You are invited to submit comments on or before **22 August 2013** by one of the following means:

By mail to: Financial Infrastructure Development Division
Financial Infrastructure Department
Hong Kong Monetary Authority
55/F, Two International Finance Centre
8 Finance Street
Central
Hong Kong

By fax to: (852) 2878 7914

By email to: cssab@hkma.gov.hk

5. The FSTB and HKMA may reproduce, quote, summarize or publish any written comments received, in whole or in part, in any form and use without seeking prior permission of the contributing parties.

6. Names of the contributing parties and their affiliation(s) may be referred to in other documents published and disseminated through different

means after the consultation by the FSTB or HKMA. If any contributing parties do not wish their names and/or affiliations to be disclosed, please expressly state so in the written comments. Any personal data provided will only be used by the FSTB, the HKMA, or other government departments/agencies for the purposes related to this consultation, the exercise of the statutory functions of the HKMA or any other purposes as permitted by law. In accordance with the Personal Data (Privacy) Ordinance (Cap. 486 of the Laws of Hong Kong), a person will have the right to request access to and correct the personal data submitted. The FSTB and the HKMA will have the right to charge a reasonable fee for processing any data access request. Personal data provided by the FSTB and/or the HKMA in response to this consultation paper will be retained for such period as may be necessary for the proper discharge of the FSTB's and the HKMA's respective functions. Any enquiries regarding the personal data provided in your submission on this consultation paper, or request for access to personal data or correction of personal data, should be addressed in writing to:

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Glossary

AIs	Authorized institutions
AMLO	Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615 of the Laws of Hong Kong)
Bank	a bank which holds a valid banking licence under the Banking Ordinance (Cap. 155 of the Laws of Hong Kong)
BO	Banking Ordinance (Cap. 155 of the Laws of Hong Kong)
C&ED	Customs and Excise Department
CSSAB	Clearing and Settlement Systems (Amendment) Bill 2013
CSSO	Clearing and Settlement Systems Ordinance (Cap. 584 of the Laws of Hong Kong)
DPS	Deposit protection scheme under the Deposit Protection Scheme Ordinance (Cap. 581 of the Laws of Hong Kong)
DPSO	Deposit Protection Scheme Ordinance (Cap. 581 of the Laws of Hong Kong)
DTC	Deposit-taking company
FS	Financial Secretary
IFC	International financial centre
MPFSO	Mandatory Provident Fund Schemes Ordinance (Cap. 485 of the Laws of Hong Kong)
MPSVC	Multi-purpose stored value card
MSO	Money service operator
NFC	Near field communication
RLB	Restricted licence bank
RPS	Retail payment systems
SFO	Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong)

SI	Settlement institution
SO	System operator
SPV	Special purpose vehicle
SVF or SVFs	Stored value facility or stored value facilities
TSM	Trusted service manager in relation to mobile payment

Executive Summary

1. The rapid development of retail payment products and services in the past few years has changed how goods and services are paid for and monies are transferred between individuals. Innovative retail payment products and services are expected to further emerge as a major means of paying small value transactions which are currently paid in cash. Typical products and services include stored value payment cards, online stored value payment facilities, mobile payment and internet payment services.

2. While the current regulatory regime for MPSVC under the BO has so far been effective in regulating device-based stored value products, there is an increasing need to expand the current regime to cover non-device based stored value products and services in light of growing acceptance of such products and services by the public. Against this backdrop, we propose a new regime for regulating both device-based and non-device based SVF as well as RPS. The policy objectives of the proposed regime are:

- (a) to ensure the safety and soundness of the operation of SVF and RPS in Hong Kong;
- (b) to ensure adequate protection and no misappropriation of float of SVF;
- (c) to foster innovation in retail payment products and services in Hong Kong by providing clarity in the laws and a level playing field for market participants; and
- (d) to maintain Hong Kong's status as an IFC by upgrading the retail payment legislation in line with what major financial centres are pursuing.

3. Taking into account practices adopted by major overseas jurisdictions and the market conditions in Hong Kong, we intend to amend the CSSO to cater for the proposed regime which will comprise the following major components:

- (a) a licensing regime for SVF under which no person shall issue or facilitate the issue of SVF in Hong Kong without being licensed by the HKMA (Section 5);
- (b) a designation regime for RPS which empowers the HKMA to designate RPS which are important to Hong Kong to be subject to the HKMA's oversight (Section 6);
- (c) powers of the HKMA to perform on-going supervision of SVF licensees and oversight of designated RPS to ensure that they are in compliance with the statutory requirements (Section 7);
- (d) powers of the HKMA to perform investigations and enforcement functions on SVF licensees and designated RPS with a view to identifying wrongdoing and sanctioning wrongdoers (Section 8);
- (e) offences, sanctions, and appeals under the proposed regulatory regime (Section 9); and
- (f) transitional arrangements to allow pre-existing SVF to migrate to the new regulatory regime in an orderly manner (Section 10).

4. The FSTB and the HKMA would like to invite comments from the public on the proposed regulatory regime for SVF and RPS as set out in this consultation document. We will take into account the comments received when finalizing the regulatory regime for SVF and RPS. Our target is to introduce the amendment bill into the Legislative Council after considering the views and comments received from the public consultation.

1. Background

1.1 The global retail payment landscape has been developing rapidly in the past decade. Technological advancements and increasing acceptance of new technologies by members of the public have led to the emergence of innovative retail payment products and services. In Hong Kong, there has been notable growth in such products and services being offered to the public. Typical products and services include stored value payment cards, online stored value payment facilities, and mobile payment and internet payment services.

1.2 While the current regulatory framework for MPSVC under the BO has so far been effective in regulating device-based stored value products, it may not be wide enough to cover such emerging non-device based products and services, the use of which by the public in Hong Kong are becoming increasingly popular. Hence, there is an increasing need to cover non-device based retail payment products and services under the current regulatory framework in light of their growing acceptance by the general public. In addition, enhancement to the regulatory regime for retail payment products and services is essential to maintaining public confidence in payment systems which, in turn, may contribute to the stability and effective working of the financial and payment systems in Hong Kong as a whole.

1.3 The proposed regulatory framework set out in this paper aims to provide for the implementation of a licensing regime for SVF covering both device-based and non-device based SVF and a designation regime for RPS in Hong Kong. Through introduction of legislative changes, the new regulatory framework seeks to ensure adequate protection of users' float maintained by the issuers of SVF and the safety and soundness of innovative retail payment products and systems in Hong Kong.

2. Current Regulatory Framework in Hong Kong

2.1 SVF

2.1.1 Currently, as mentioned before, the BO provides the legal framework for the HKMA to regulate MPSVC in Hong Kong. The regime, which

came into operation in 1997, is confined to device-based stored value products (e.g. a stored value card) and provides that only AIs which have been authorized by the HKMA may issue MPSVC.

2.1.2 Because of technological advancements, the scope of the existing MPSVC regime is now considered insufficient to capture emerging SVFs which not only store value in a device, but also on a computer network-based account or mobile network account and server. As a result, some of these SVFs are not subject to any regulation in Hong Kong.

2.2 RPS

2.2.1 The CSSO, which came into force in 2004, provides the legal framework for the HKMA to designate and oversee large-value clearing and settlement systems that are material to the monetary or financial stability of Hong Kong or to the functioning of Hong Kong as an IFC. “Clearing and settlement system” is defined in section 2 of the CSSO as follows:

“clearing and settlement system” means a system established for-

(a) the clearing or settlement of payment obligations; or

(b) the clearing or settlement of obligations for the transfer of book-entry securities, or the transfer of such securities.

2.2.2 The policy focus of the CSSO has been on the safety and efficiency of large value clearing and settlement systems and securities transfer systems which process transactions at the interbank level. The existing definition of “clearing and settlement system” is not intended to cover RPS which, apart from performing “clearing and settlement” functions for retail payment obligations, may also facilitate the transfer of retail payment related instructions and funds between two participants of the RPS.

2.2.3 Currently, the payment industry adopts an informal self-regulatory approach to ensure the safety and efficiency of selected RPS that are commonly used in Hong Kong. In 2007, a Code of Practice for Payment Card Scheme Operators was drawn up by eight payment card scheme operators with credit or debit card operations in Hong Kong. The Code, which was endorsed by the

HKMA, sets out general principles for the payment card scheme operators to observe on a voluntary basis so as to promote the safety and efficiency of payment card operations in Hong Kong and foster public confidence in their operations. Given the growing acceptance and sophistication of retail payment services and products and increasing number of retail payment systems in recent years in Hong Kong, we consider that it is now the appropriate time to expand the current regulatory framework for large-value clearing and settlement systems to cover RPS. We also notice that overseas jurisdictions such as Malaysia, Australia, the UK, the EU and the US have amended their relevant laws in these areas.

3. Policy Objectives of the Proposed Regulatory Framework

3.1 Given the growing public acceptance and usage of innovative retail payment products and services, as well as the international regulatory trend, we intend to introduce the proposed regulatory framework in respect of SVF and RPS in accordance with the following policy objectives:

- (a) to ensure the safety and soundness of the operation of SVF and RPS in Hong Kong;
- (b) to ensure adequate protection and no misappropriation of float¹ of SVF;
- (c) to foster innovation in retail payment products and services in Hong Kong by providing clarity in the laws and a level playing field for market participants; and
- (d) to maintain Hong Kong's status as an IFC by upgrading the retail payment legislation in line with what major financial centres are pursuing.

¹ "Float" refers to the total sum of money paid by a user to an issuer, including any other sum of money received on the account of the users, for storage on the SVF.

Consultation question:

Q1. Do you agree with these policy objectives in respect of regulating SVF and RPS in light of rapid innovation of the global retail payment landscape and regulatory trends?

4. Legislative Approach

4.1 The FSTB and the HKMA intend to amend the CSSO to give effect to the proposed new regulatory framework for SVF and RPS. The reasons for adopting this approach are as follows:

- (a) the CSSO already provides a comprehensive regulatory framework for large-value clearing and settlement systems. This includes powers of the HKMA to designate certain clearing and settlement systems to be subject to the HKMA's oversight and to impose safety and efficiency requirements on designated systems, and the establishment of an appeal mechanism for parties aggrieved by certain decisions of the HKMA under the CSSO. Such a comprehensive framework forms a solid foundation and can be readily extended to cover the regulation of RPS. The proposed arrangement also avoids duplicating the regulatory framework and powers in different legislation which may cause confusion to the payment industry;
- (b) it is more appropriate to incorporate the regulations on SVF into the CSSO rather than other ordinances to avoid any implication that payment service providers are subject to certain regulations that are not relevant to them;
- (c) the proposed legislative approach will provide a uniform basis in policy and regulation setting, and help establish a consistent regulatory environment for the operation of payment-related products and services; and
- (d) the proposed legislative approach is in line with the arrangements in some overseas jurisdictions, i.e. their respective regulatory

frameworks for large value clearing and settlement systems, RPS and SVF are all prescribed in a single piece of legislation.

4.2 The existing MPSVC regime under the BO is proposed to be repealed upon the commencement of the CSSAB. It is proposed that new parts be added to the CSSO to cover regulations for SVF and RPS. The new part on SVF will provide a licensing, supervisory, enforcement and disciplinary regime for SVF activities. The new part on RPS, on the other hand, will provide a designation, supervisory, enforcement and disciplinary regime for RPS operators. The proposed new parts will also provide the HKMA with the necessary powers to implement the two new regimes.

5. Regulatory Framework for SVF

5.1 Need for a SVF Licensing Regime

5.1.1 The primary regulatory concern of SVF stems from the protection of users' float maintained by the SVF issuers. This calls for a more comprehensive regulatory regime to ensure issuers' soundness and proper protection and management of the float. It is proposed that a mandatory licensing regime for SVF be introduced in the CSSAB. This section sets out the implementation arrangements of the proposed SVF licensing regime.

5.2 Definitions of SVF

5.2.1 SVF can be classified into two broad categories according to the scope of their usage, namely multi-purpose and single-purpose SVF. Multi-purpose SVF, which may be understood as "open-loop prepaid" facilities in the payment industry, can be used as a means of payment for goods and services provided by participating merchants at designated locations and points. Single-purpose SVF, which may be understood as "closed-loop prepaid" facilities in the payment industry, is used as a means of payment for goods and services provided by the merchant which is also the SVF issuer.

5.2.2 Since the current regulatory framework for MPSVC under the BO has been effective in regulating device-based stored value products, the proposed new definition of multi-purpose SVF will be based on the existing definition of

MPSVC. It will, however, be given a wider scope that encompasses both device-based and non-device based facilities (other than cash). The non-device based products include mobile network accounts or computer network-based accounts which can store value and be used as a means of payment for goods and services and/or for making payment to or receiving payment from another person. For this purpose, it is proposed that “multi-purpose SVF” be defined along the following lines:

“stored value facility” means a facility (other than cash or a single-purpose stored value facility) for or in relation to which a person (user), or another person on the user’s behalf, pays a sum of money (including money’s worth) to the issuer, whether directly or indirectly, in exchange for:

- (a) the storage of the value of -*
 - (i) that money (including money’s worth), whether in whole or in part, on the facility; and*
 - (ii) any other sum of money (including money’s worth), if any, otherwise received on the account of the user (and whether or not it was so received from the user or another person on behalf of the user) on the facility which may be so stored under the operating rules of the facility, and*
- (b) the relevant undertaking.*

5.2.3 The term “relevant undertaking” in relation to multi-purpose SVF intends to mean the obligation undertaken by the SVF issuer that, on the production of the SVF to the issuer or a third party, the issuer or the third party will supply goods and services; make payment for goods and services; or make payment to another party. For example, when a customer puts a multi-purpose SVF on a card reader at a fast-food chain store to purchase a meal, the SVF issuer undertakes that the fast-food chain store, being a third party procured by the SVF issuer, will supply the meal to the customer (provided that there is sufficient value on the SVF to pay for the meal). Another example is a person-to-person payment between two SVF users, where the SVF issuer undertakes to effect funds transfer between the two SVFs’ account upon receiving the payment instruction from one

of the two users. For this purpose, “relevant undertaking” is intended to have the following meaning:

“relevant undertaking”, in relation to a multi-purpose SVF, means an undertaking by the issuer that, upon the use of the facility by the user as a means for payment for goods and services (which may be or include money or money’s worth) or payment to another person, and whether or not some other action is also required, the issuer, or a third party that the issuer has procured to do so, will, in accordance with the operating rules:

- (i) supply the goods or services;*
- (ii) make payment for the goods or services; or*
- (iii) make payment to the other person,*

as the case requires.

5.2.4 For “single-purpose SVF”, the definition set out in the BO in relation to the single-purpose stored value card is proposed to be modified as follows:

“Single-purpose stored value facility” means a facility (other than cash) for or in relation to which a person pays a sum of money (including money’s worth) to the issuer of the facility, whether directly or indirectly, in exchange for:

- (a) the storage of the value of-*
 - (i) that money (including money’s worth); whether in whole or in part, on the facility; and*
 - (ii) any other sum of money (including money’s worth), if any, otherwise received on the account of that person, and*
- (b) an undertaking (whether express or implied) by the issuer that, upon the use of that facility by that person*

as a means of payment for goods or services not being money or money's worth, and whether or not some other action is also required, the issuer will, in accordance with the rules or terms that govern the functioning, operations or use of the facility, supply the goods or services.

(Please see section 5.4.3.1)

5.2.5 The use of the term “money’s worth” in the above definitions aims to put it beyond doubt that: i) value added onto a SVF by the user; ii) value received on the user’s SVF account; and iii) value redeemed by the SVF user include not only “money” in the primary sense but also other forms of monetary consideration. For example, a value top-up of a SVF account may take the form of points earned by the SVF user from making purchases of goods and services. Similarly, value received on the account of the SVF user may take the form of an on-line transfer of value or points between fellow SVF users, while redemption of value in a SVF can be in the form of gift-vouchers which are not “money” in its primary sense.

5.3 SVF vis-à-vis Deposit Taking

5.3.1 In view of the specific character of SVF as an electronic surrogate for coins and banknotes which is akin to a means of payment rather than a means of saving, the policy intention is to draw a clear distinction between SVF and deposits. It is, therefore, proposed that the float arising from the issue of SVF under the CSSAB will be excluded from the definition of “deposit” for the purpose of the BO. As a result, non-bank payment service providers may also issue SVF without being bound by the restrictions on “deposit-taking” under the BO. Nevertheless, in order to protect SVF users, it is the FSTB’s and the HKMA’s current thinking that non-bank SVF licensees will be required under the CSSAB to have in place measures to safeguard the float to protect SVF users (please see section 5.5 below).

Consultation questions:

Q2. Do the proposed definitions cover all SVF products prevailing in the market that should be subject to the proposed regulatory regime?

Q3. Are there any other elements that you think would be practical and relevant to determine whether a SVF is multi-purpose or single-purpose?

5.4 Licensing Regime for SVF

5.4.1 Issuer licence

5.4.1.1 It is proposed that under the new SVF regime, no person shall issue SVFs in Hong Kong unless it is a company incorporated in Hong Kong and holds a licence granted by the HKMA. It will be a criminal offence to issue SVFs without complying with the aforesaid requirements. In the case of a Hong Kong branch or office of a foreign corporation, it is regarded as not meeting the requirement of “a company incorporated in Hong Kong”. In other words, a foreign company which intends to issue SVF in Hong Kong will need to incorporate a company under Hong Kong law and apply to the HKMA for a licence. The purpose of this requirement is to ensure the float arising from the issue of SVF will be appropriately segregated from and not be commingled with the funds of the foreign company and be kept separately in Hong Kong for the purpose of float safeguarding. The requirement will also allow the HKMA to have a handle on network-based SVF issuers who provide services from outside Hong Kong through, for example, the internet, and to exercise effective supervision on such entities.

5.4.2 Licensed banks deemed to be licensed

5.4.2.1 In line with the existing MPSVC regime under the BO, it is proposed that licensed banks will be deemed to be licensed to issue or facilitate the issue of SVF (please see section 5.4.4 below for the facilitator licence). Therefore, they are not required to go through the SVF licensing process under the CSSAB. However, they are still required to comply with the relevant provisions which are applicable to licensed banks in the CSSAB should they decide to embark on a SVF business. The reasons for giving licensed banks a deemed status are as follows:

- (a) licensed banks are already subject to stringent regulatory requirements including authorization process and on-going supervision by the HKMA on a holistic basis;
- (b) while licensed banks are required to demonstrate to the HKMA that they are capable of undertaking and have adequate controls in place over certain new business activities, licensed banks are not, in general, required to seek specific approval from the HKMA in respect of the new business activities in which they may engage, including issuing of SVF; and
- (c) the arrangement is in line with international practices where SVF issuers who are banks are generally not required to be authorized or licensed as they are already subject to the relevant banking regulations.

5.4.3 Single-purpose SVF not required to be licensed

5.4.3.1 Taking into account the existing MPSVC regime under the BO as well as practices adopted by major overseas jurisdictions including the UK and the US, it is proposed that single-purpose SVF will not be required to be subject to the licensing regime. Single-purpose SVFs are those facilities which can only be used to purchase goods and/or services provided by the SVF issuer. The typical examples include customer loyalty cards and bonus point cards such as stored value cards issued by a coffee shop chain for purchasing coffee, cakes, and snacks, etc. provided by the coffee shops belonging to that chain; pre-paid coupons and gift cards issued by department stores; petrol station loyalty schemes; cake shop coupons; and other “closed-loop” stored value card schemes the issuers of which are also the providers of the goods and services.

5.4.3.2 The reasons of not subjecting single-purpose SVF to the proposed licensing regime are as follows:

- (a) single-purpose SVFs are in essence bilateral contractual arrangements for payment between users and SVF issuers (e.g. users making advance payment to secure provision of goods and/or services by the issuers) rather than electronic surrogate for coins and banknotes;

- (b) imposing the proposed regulations such as financial resources and float management requirements on single-purpose SVF would likely result in over-regulation which drives most of the existing single-purpose SVF schemes out of business, thereby depriving consumers of choice and stifling business innovation;
- (c) we note that other major overseas regulators do not regulate single-purpose SVFs in their markets, the key reason being the same as that outlined in (a) above; and
- (d) single-purpose SVF, given its bilateral nature and magnitude, generally presents insignificant risks to the financial and payment systems of Hong Kong.

5.4.3.3 Notwithstanding the above, the FSTB and the HKMA are aware that there have been growing concerns about consumer disputes arising from certain single-purpose SVFs or prepaid schemes such as prepaid schemes/vouchers/cards for fitness centre memberships and beauty parlour service packages. While the regulatory regime on SVF being proposed aims to maintain the safety and soundness of payment systems and instruments rather than addressing consumer disputes and issues on single-purpose prepaid schemes, we acknowledge the need to address such consumer issues through other regulations or consumer protection measures. In any event, other major markets' experiences show that a single-purpose SVF would only have material risk implication to the financial market and consumers if they expand the coverage of their businesses and become a multi-purpose SVF. In such cases, the proposed regulatory regime for SVF stands ready to provide a sound supervisory framework to ensure the safety and soundness of all multi-purpose SVFs.

5.4.4 Facilitator licence

5.4.4.1 In line with the existing MPSVC regime under the BO, it is proposed that a person who facilitates the issue of SVF will be required to obtain a "facilitator licence" under the SVF licensing regime. The concept of "facilitator" is not new to the proposed regime. The term was introduced when the BO was amended in 1997 to cater for the business models of certain MPSVC which involved two functions: (a) origination of electronic value for storage in MPSVC; and (b) distribution of the MPSVC to users. These two functions could be performed by the same party or different parties. In this respect, an originator who

creates electronic value for storage in MPSVC and then sells the MPSVC to other entities for issuing to the users would fall within the definition of “facilitator”.

5.4.4.2 A major example to illustrate the concept of “facilitator” was the Mondex Scheme (which ceased operation many years ago and is no longer in operation in the current market). Under that scheme, Mondex was the originator of Mondex values which were sold to Mondex member banks for onward selling to retail customers. In return, Mondex received cash from its member banks and held a pool of funds which backed the Mondex values in circulation. Mondex values issued were stored in card-based devices which could be used for payment for goods and services in accepting locations. Consumers and merchants could redeem Mondex value in cash from their issuing banks. The issuing banks, in turn, could redeem the Mondex value for funds from Mondex. In this case, Mondex fell into the definition of “facilitator” as it facilitated the issue of Mondex cards by its member banks by originating the electronic value contained in the card in the first place.

5.4.4.3 While the business model involving a “facilitator” in issuing SVF is not common in the current market, it is considered necessary to retain the facilitator concept for the purpose of the proposed SVF regime to ensure that the necessary supervisory powers are in place should any entity prepares to assume the role of a facilitator in future. The FSTB’s and the HKMA’s current thinking is to give the term, “facilitate”, the following meaning:

“facilitate” means “facilitate the issue of a SVF by another person (“the issuer”) by the provision, directly or indirectly or by electronic means or otherwise, by the facilitator to the issuer of valuable consideration the value of which determines, whether in whole or in part, the extent to which the issuer may provide any undertaking referred to in the definition of “stored value facility” in respect of such stored value facility.”

5.4.4.4 It should be noted that the term “facilitator” has its own technical meaning for the purpose of the proposed SVF regime and should be distinguished from the general meaning of the term. For the avoidance of doubt, persons who provide ancillary or outsourcing services for assisting the operation of the issuer of a SVF such as advertising, payment collection, electronic data network facilities, information technology support, or programme managers in the context of prepaid

card programmes² will generally not be considered to be acting as a “facilitator” for the purpose of the proposed SVF regime.

Consultation questions:

- Q4. Do you have any comments on the proposed licensing regime for SVF?*
- Q5. Are the meanings of “issuer” and “facilitator” clear? Are there any examples of the role or functions of “issuer” or “facilitator” not reflected in the definition?*
- Q6. Do you have any comments regarding licensed banks being deemed to be licensed for issuing and/or facilitating the issue of SVF?*
- Q7. Do you have any comments on the proposed treatments for single-purpose SVF?*

5.4.5 Licensing criteria and conditions

5.4.5.1 In line with the existing MPSVC regime where applicants for authorization to issue MPSVC are required to meet an array of authorization criteria set out in the Seventh Schedule to the BO, it is proposed that a list of the licensing criteria for SVF licences be stipulated in the CSSAB. The licensing criteria will be applied on an on-going basis after the licensee has been granted a licence for issuing or facilitating the issue of SVF. It is proposed that the licensing criteria should include, inter alia, the following:

- (a) *Physical presence in Hong Kong:* the SVF issuer/facilitator must be a body corporate under Hong Kong law and have a registered office in Hong Kong (see section 5.4.1 above for the rationales behind the local incorporation criteria).
- (b) *Principal business:* the principal business of the SVF issuer/facilitator must be the issuing of and/or facilitating of the issue of SVF. The purpose of this criterion is to ensure the principal resources of the licensee will only be used on its SVF business. Some SVF schemes may involve the provision of remittance and/or

² Programme manager is the owner of a prepaid stored value card programme. The programme manager typically is responsible for establishing relationships with processors, banks, payments networks and distributors; and for establishing pooled accounts at banks.

money changing service as ancillary or incidental services to its SVF issuing business, but not as part of their principal business. It should be noted that such services may fall within the MSO licensing regime administered by the C&ED under the AMLO. To avoid any regulatory gaps or overlaps between SVF and MSO for the purposes of the AMLO, the current thinking of the FSTB and the HKMA is to adopt a holistic approach in the regulation of SVF issuer/facilitator whose operations involve remittance and/or money changing services as ancillary or incidental services. That is, such SVF issuer/facilitator will only need to obtain the SVF licence from the HKMA and be subject to the regulation of the HKMA in respect of AML issues and will not be required to obtain MSO licence from the C&ED.

- (c) *Financial strength requirements:* the SVF issuer/facilitator must meet the minimum on-going capital requirement that the aggregate amount of its paid-up capital and the balance of its share premium account, if any, should not be less than HK\$25,000,000 or an equivalent amount in any other approved currency (We intend to adopt the definition of “approved currency” as set out in the BO). This is in line with the current arrangements for the MPSVC regime under the BO. That is, where an applicant intends to issue MPSVC, it will be required to set up a SPV and be authorized as a DTC and be subject to, among other things, a minimum level of share capital of HK\$25,000,000. Given that adequate measures have been proposed for the protection of float (see section 5.5), it is considered that the proposed approach for on-going capital requirement should suffice in ensuring SVF licensee to have adequate financial resources to sustain its operation while not hindering new issuers from entering into the Hong Kong market. Nevertheless, the HKMA may impose a higher level of share capital on a SVF licensee via a licensing condition if the HKMA considers appropriate. For example, the HKMA may require a higher share capital amount for a global SVF issuer which has a material market share in Hong Kong and involves in significant cross-border payment activities.
- (d) *“Fit and proper” requirements on management and ownership:* any persons having a qualifying holding in the SVF issuer/facilitator must be fit and proper persons, and the persons responsible for the

management of the SVF business must possess appropriate knowledge and experience in providing SVF and related services.

- (e) *Knowledge and experience:* the officers of the SVF issuer/facilitator who will be responsible for implementing the relevant scheme or the day-to-day management of the relevant scheme must have the appropriate knowledge and experience to effectively discharge that responsibility.
- (f) *Prudential and risk management requirements:* the SVF issuer/facilitator must have in place appropriate risk management processes and measures for its operation. These may include, inter alia, adequate security and internal controls to ensure the safety and integrity of data and systems; effective fraud monitoring and detection measures; robust and well-tested contingency arrangements to address operational disruptions; and any other operational and security safeguards which commensurate with the scale and complexity of the scheme.
- (g) *Anti-money Laundering (AML) and Counter-Terrorist Financing (CTF) requirements:* the SVF issuer/facilitator must satisfy the HKMA that the design and implementation of the scheme have in place efficient filtering and detecting mechanisms against possible AML and CTF transactions. They must comply with applicable AML and CTF legislation and relevant rules and regulations issued by the HKMA and other authorities from time to time (please also refer to (b) for regulation of AML).
- (h) *Management of float:* the SVF issuer/facilitator must have adequate risk management policies and procedures for the management of the float to ensure that there will be sufficient funds for the redemption of outstanding stored value. (see section 5.5 below)
- (i) *Redemption requirements:* the SVF issuer/facilitator must redeem in full the value stored upon receiving a redemption request from a user. The contract with a SVF user must clearly and prominently states the conditions of redemption, including any fees relating to the redemption and expiry period of the stored value, if any.

- (j) *Operating rules:* the SVF issuer/facilitator must have operating rules for the relevant scheme that are sound and prudent having regard to the purpose of the relevant scheme.
- (k) *Purpose and Soundness of the SVF scheme:* the SVF issuer/facilitator must satisfy the HKMA that the relevant scheme will be operated prudently and with competence and in a manner that will not adversely affect the stability of any payment system in Hong Kong and the interests of users or potential users of the scheme.

5.4.5.2 Since banks are already subject to similar or more stringent prudential requirements, it is therefore proposed that the licensing criteria (a), (b), (c) and (h) do not apply to SVF issuer/facilitator which is a bank. In addition to licensing criteria, it is proposed that the HKMA be empowered to impose on-going licensing conditions on a SVF licence. The HKMA will determine the details of such conditions to be attached on a case-by-case basis. Such conditions may include, for example, requirements on management of the float and restriction on the maximum value to be stored and daily transaction limit on the facility.

Consultation question:

Q8. Do you have any comments on any of the proposed licensing criteria and conditions as set out above?

5.4.6 Other licensing matters

5.4.6.1 It is proposed that a SVF licensee may issue or facilitate the issue of more than one SVF under the same licence (e.g. issue of both device-based and non-device based SVFs by the same issuer). The SVF licensee will be required to discuss with the HKMA before it issues a new SVF under its licence. The purpose of this requirement is to ensure the safety and soundness of the new SVF and that it will not jeopardise the operation of the existing SVF. It is also proposed that the licence of a licensee (other than a bank) is transferrable to another company provided that the HKMA's prior approval is sought.

5.4.6.2 It is the FSTB's and the HKMA's current thinking that all SVF licensees will be required to display the licence number on the SVF it issued (if feasible) and on the packaging and advertising materials so that the public could

be made aware of their licensing status. The HKMA will maintain a central register of all SVF licensees and it will be accessible by the general public for checking.

5.4.6.3 It is proposed that the HKMA be empowered to levy SVF licence fees from SVF licensees (including licensees who are banks) on an annual basis. In determining the level of licence fees, the HKMA intends to make reference to the registration fee for DTC as currently set out in the BO.

Consultation question:

Q9. Do you agree that the HKMA's prior approval is required for transferring a SVF licence? If not, why not? Please give your reasons.

5.4.7 HKMA's power to exempt certain SVF

5.4.7.1 In line with the existing exemption arrangements of the MPSVC regime under the BO, it is proposed that the HKMA should retain the discretion to exempt a SVF from being required to obtain a licence. The HKMA's approach is to give a reasonably wide definition to SVF so that it will catch potential SVF, and at the same time, give appropriate flexibility to the HKMA to exempt some SVF or class of SVF which fall within the statutory criteria which are set out in section 5.4.7.2(a) and (b) below.

5.4.7.2 The exercise of the exemption power will be at the HKMA's discretion and the HKMA may take into account, among other things, the risks posed by the SVF to users or to the financial and payment systems of Hong Kong as a whole, and whether to require the issuer of the SVF to be licensed would amount to regulatory "overkill" and hinder small scale SVFs from further developments. In this connection, it is our current thinking that the following types of SVF would be eligible for consideration for exemption:

- (a) SVF that can be used to acquire goods or services only in or within a close proximity to the issuer's premises (e.g. university student stored value card for purchase of goods and services within the campus; stored value cards which can only be used in one department store or a limited number of its store branches, etc.); and

- (b) the SVF issuers that, under a commercial agreement with a limited group of service providers, provide a limited range of goods or services (e.g. petrol cards for refuelling, and also, for purchasing goods provided by a few other providers at a specified chain of petrol stations and shops at these stations; membership cards which can only be used to pay for goods and services offered by a few shops, clubs or organisations).

5.4.7.3 SVF issued by a large conglomerate which can be used to acquire a variety of goods and services provided by affiliated companies and subsidiaries under the same group such as large supermarkets, pharmacies, convenient stores, restaurants and café, etc. will generally not be eligible for exemption under the proposed new regime. Likewise, SVF issued by large property developers for use in housing estates and shopping and residential complexes would generally be considered as multi-purpose SVF given their widely-accepted nature, and therefore, would not be qualified for exemption under the proposed SVF licensing regime.

5.4.7.4 In granting an exemption, the HKMA may attach conditions to the exemption to require the issuer/facilitator to do such things as the HKMA may specify so as to satisfy the HKMA that the exemption status of the issuer/facilitator remains valid. For example, the HKMA may require exempted SVF issuer/facilitators to notify the HKMA of any expansion or change in business scope that may cause the HKMA to reconsider the exemption.

Consultation question:

Q10. Do you have any comments in relation to the HKMA's power to exempt certain SVF from the licensing regime?

5.5 Float Management and Safeguarding

5.5.0 There are currently no specific requirements on the protection of float under the existing MPSVC regime. Issuers of MPSVC are required to discuss with the HKMA individually on float management. It is proposed that clear statutory backing for the protection of float will be stipulated in the CSSAB. The following sections set out the proposed float safeguarding approaches applicable to SVF licensees which are non-bank payment service providers and

those which are licensed banks. The requirements will also apply to the management of SVF deposits³ so that such deposits receive the same degree of protection.

5.5.1 Non-bank SVF licensees

5.5.1.1 For non-bank SVF licensees, it is proposed that the CSSAB will stipulate the following principles in relation to float safeguarding:

- (a) the float must be kept separate from the SVF licensee's other funds; and
- (b) the float must be at least 100% protected by safeguarding measures.

5.5.1.2 Non-bank SVF licensees will need to demonstrate to the HKMA that they have put in place measures that will ensure on-going compliance with the above float safeguarding principles. The HKMA will give guidance as to the type of acceptable float safeguarding measures through the issuance of guidelines. The current thinking is that the following types of float safeguarding measures would be considered acceptable: i) bank guarantee from a licensed bank in Hong Kong; and ii) trust account maintained with a licensed bank in Hong Kong. In practice, the HKMA will discuss with each non-bank SVF licensee regarding its float safeguarding approach to ensure that the proposed measures will provide adequate protection and that such approach will best suit the licensee's business operation and risks profile. On-going compliance with the agreed float safeguarding approach will be a licensing condition attached to the SVF licence.

5.5.2 SVF licensees which are licensed banks

5.5.2.1 Taking into account the fact that licensed banks are already subject to stringent prudential requirements including liquidity and capital adequacy requirements, etc., and that the size of the outstanding float of a typical SVF would likely be relatively small as compared to the deposit base of a typical licensed bank, our current thinking is not to apply the float safeguarding requirements mentioned in section 5.5.1.1 and 5.5.1.2 above to SVF issuers/facilitators which are licensed banks. It is also in line with the practices adopted in some overseas jurisdictions.

³ SVF deposit refers to a deposit (not being any part of the float of the SVF) placed by a person with a SVF licensee for the purpose of enabling the person to become a user of the SVF.

5.5.2.2 Nevertheless, we intend to require SVF issuers/facilitators which are licensed banks to implement sufficient control measures for adequate protection of the float and to submit the proposed control measures to the HKMA for consideration. The HKMA will review the adequacy of such measures proposed by the licensed banks as part of the on-going supervision processes.

5.5.3 Investment of float

5.5.3.1 It is the FSTB's and the HKMA's current thinking that the float arising from SVF should only be invested in good quality and highly liquid assets. In determining the type of assets that the float can be used to invest in, the SVF licensees should take into account the liquidity requirements of the SVF scheme and how the float will be managed and invested to meet such requirements. The HKMA will need to be satisfied that the types of investment which the licensee proposes to invest in are appropriate having regard to the financial strength, overall corporate governance, and risk management controls of the SVF issuers/facilitators. The HKMA will review the investment strategy in consultation with the SVF licensee from time to time as the SVF business develops.

Consultation questions:

- Q11. Do you have any comment on the proposed principles in relation to float safeguarding such as segregation of float from other funds and 100% float protection by safeguarding measures for non-bank issuers?*
- Q12. Are there any other suggestions on float safeguarding arrangements other than the proposed guarantee or trust account?*
- Q13. Do you have any other comments on the proposed measures for the float protection requirement?*

5.6 Limit on Maximum Amount Stored on a SVF

5.6.1 Under the proposed new SVF licensing regime, the HKMA may determine the limits on the maximum amount of value that can be stored on and the maximum value of daily transaction of individual SVF. The HKMA will take into account the size of the SVF scheme's operation, number of users, business/operating model, risk management measures, AML control procedures,

etc. when determining whether or not to impose such limits. The HKMA will also seek to maintain a balance between convenience of use, risks of loss/theft and AML issues when considering the limits. In practice, the HKMA will discuss with each licensee when considering whether or not to impose limits on each SVF scheme on a case-by-case basis. If the HKMA considers appropriate to do so, it will impose such limits by attaching a licensing condition on the licence. The limits will be subject to review on a periodic or need basis taking into account the development and business needs of the SVF scheme in question.

5.6.2 It should be noted that currently Schedule 2 (record-keeping and customer due diligence requirements) of the AMLO does not apply to a MPSVC which has a maximum stored value of not exceeding HK\$3,000. Our current thinking is to amend the AMLO by way of a consequential amendment so that the reference to MPSVC is to be replaced by SVF, i.e. both device-based and non-device based SVF.

Consultation questions:

Q14. Do you have any comments on the proposed regulatory arrangements on the limit that can be set for individual SVFs?

Q15. Do you have any suggestions on factors that need to be taken into account when determining the maximum limits during the licensing process?

6. Regulatory Framework for RPS

6.1 Proposed Designation Regime

6.1.1 Safe and efficient functioning of widely used RPS is essential to the smooth running of the day-to-day economic activities. Any disruptions to a RPS could be detrimental to public interest and affect public confidence in the payment systems in Hong Kong which, in turn, may have an adverse impact on the financial stability as a whole. In line with the existing regulatory approach for large value clearing and settlement systems in Hong Kong, it is proposed that a designation regime be established under the CSSAB to empower the HKMA to designate and oversee RPS that are of importance to the general public and financial stability of Hong Kong.

6.2 Meaning of RPS

6.2.1 The current thinking is to give the following meaning to a “RPS”:

“Retail payment system” means “a system for the transfer, clearing or settlement of payment obligations which are related to retail activities involving purchases or payments, principally by individuals, and includes any instrument and procedures that relate to the system”.

6.2.2 It is proposed that the term “system” in relation to RPS will include “arrangements” to cover those RPS that may not involve a “physical system”. It is also proposed that “infrastructure” that plays an important role in a RPS will be brought under the scope of RPS. Nonetheless, it is not the policy intention to include other ancillary and outsourcing service providers such as computer system operators and telecommunication network facilities within the scope of RPS.

6.2.3 It is envisaged that the proposed meaning of RPS will cover credit card schemes, debit card schemes, large merchant acquirers, payment gateways, and mobile payment infrastructure (e.g. the infrastructure of the TSM of NFC mobile payment services⁴). The policy intention is not to cover RPS operated by an AI, e.g. internet and mobile banking services, electronic fund transfer services, ATM networks etc., for serving their own customers because such RPS are already subject to the HKMA’s prudential supervision of the AI as a whole. However, if an AI provides RPS services to other payment service providers, such RPS may be subject to designation if it falls within the proposed designation criteria set out below.

Consultation questions:

Q16. Do you have any comments on the proposed meaning and coverage of RPS?

⁴ NFC technology enables consumers to install, among other things, mobile payment applications such as e-purse onto their mobile phones and make contactless payment at retail outlets by tapping their mobile phones to the readers installed at the outlets. TSM is a trusted party which provides a platform to securely distribute, provision and manage the life cycle of NFC payment applications for the customers of mobile network operators on behalf of payment service providers.

6.3 Considerations for Designation

6.3.1 It is proposed that RPS which operates in Hong Kong or processes Hong Kong dollar denominated retail payment transactions would be eligible for consideration for designation. In addition, the HKMA and the FSTB envisage that a RPS that processes transactions denominated in currencies other than Hong Kong dollar may, in some circumstances, be of prudential concern to the HKMA. Accordingly, it is proposed that the HKMA be empowered to prescribe currencies other than Hong Kong dollar in determining the eligibility of RPS for designation.

6.3.2 In line with the existing arrangements for large value clearing and settlement systems under the CSSO, it is proposed that flexibility be given to the HKMA to grant exemption to designated RPS established outside Hong Kong from certain obligations if the HKMA is satisfied that the RPS is already subject to adequate supervision by its home supervisor. Before granting exemption to a designated RPS, the HKMA will liaise with the home supervisor and assess whether or not adequate supervision of the designated RPS is already in place.

6.3.3 It is noted that SVF schemes normally require a clearing and settlement system to support their operation. Such a system may fall within the RPS definition. To avoid regulatory overlap and inducing excess regulatory burden on SVF licensees, our current thinking is not to designate a clearing and settlement system run by a SVF licensee to support its own SVF schemes because the entire SVF schemes and related systems are already subject to a holistic regulatory framework, covering the safety and soundness of the systems including those systems supporting the clearing and settlement operation. However, if the RPS operated by the SVF issuers also supports SVF schemes run by other issuers, the HKMA may designate such RPS if it meets the designation criteria (see section 6.4).

6.4 Designation Criteria

6.4.1 In line with the current designation arrangement in respect of large value clearing and settlement systems under the CSSO, it is proposed that the HKMA may designate a RPS if any disruptions to the RPS are likely to result in any one or more of the following:

- (a) monetary or financial stability; or the functioning of Hong Kong as an IFC being adversely affected;

- (b) public confidence in payment systems or the financial system of Hong Kong being adversely affected; or
- (c) day-to-day commercial activities in Hong Kong being adversely and materially affected.

6.4.2 In qualifying the above, it is proposed that the HKMA may take into account, the following quantitative factors:

- (a) the estimated aggregate value of orders transferred, processed, cleared or settled through the system;
- (b) the estimated average value of orders transferred, processed, cleared or settled by the system;
- (c) the estimated number of orders transferred, processed, cleared or settled by the system;
- (d) the estimated number of participants or users of the system;
- (e) any direct or indirect interfaces to the large value payment systems; and
- (f) any other considerations the HKMA thinks relevant.

Consultation questions:

Q17. Do you have any comments on the proposed criteria for designating RPS?

Q18. Do you have any comments on the proposed factors to be considered for qualifying the designation criteria?

6.5 Requirements on Designated RPS

6.5.1 Designated RPS will be subject to oversight by the HKMA and the SO and/or SI of the designated RPS will be answerable to the HKMA on all regulatory issues. In this respect, our current thinking is to give the terms “SO” and “SI” the following meanings:

- (a) “SO” means any person who, for the purpose of the system’s operating rules, is responsible for the operation of the transfer, clearing, or settlement functions, or any other functions of the system which fall within the meaning of RPS; and
- (b) “SI” means any person who provides for the settlement of a payment obligation relating to retail activities, for the purpose of the operating rules of the system.

6.5.2 It is envisaged that the term “SO” will be relevant to most RPS. In the context of credit card and debit card industry, payment card network operators who create standards and procedures for the receipt, transmission and processing of payments made by credit or debit cards and allow for the electronic transfer of information and funds will generally be regarded as “SO” under the proposed new RPS regime. Operators of RPS such as payment gateways and bill payment systems may also fall within the meaning of “SO”. It should be noted that while some RPS may outsource the operation of their systems to a third party company, the company which owns and manages the RPS will remain to be the “SO” for the purpose of the RPS regime.

6.5.3 The term “SI”, on the other hand, is adapted from the large value clearing and settlement regime under the CSSO and refers to the institution across whose books transfers between participants take place in order to achieve settlement within a settlement system. It is envisaged that not all RPS would perform settlement functions for retail payments and hence the term “SI” may not be relevant to most RPS.

6.5.4 To ensure the safety and robustness of designated RPS, it is proposed that designated RPS will be required to have in place operating rules to provide for the system to be operated in accordance with the requirements of the CSSAB, including relevant default arrangements which are appropriate and adequate for the system.

6.5.5 It is also proposed that designated RPS should be subject to safety requirements which include, among other things, risk management and control procedures relating to the operation of the system; safety and integrity of information held within the system; soundness of the system including financial

soundness; and efficiency requirements including cost of participation and reasonableness of criteria for admission as a participant in the system.

6.5.6 Designated RPS will be required to comply with all the applicable AMLO requirements. Similar to SVF, some RPS operations may involve the provision of remittance and/or money changing services. Such services may fall within the MSO licensing regime administered by the C&ED under the AMLO. The current thinking of the FSTB and the HKMA is to adopt a holistic approach in the regulation of the designated RPS whose operations involve remittance and/or money changing services under which such designated RPS will only need to be subject to the HKMA's supervision in respect of AML issues and will not be required to obtain a MSO licence from C&ED. Entities other than designated RPS and SVF licensees (as mentioned in section 5.4.5.1 (b) above) which engage in the provision of remittance and/or money changing services will continue to be licensed by the C&ED under the AMLO.

6.5.7 The HKMA will review the status of the "Code of Practice for Payment Card Schemes"⁵ in consultation with the industry upon the implementation of the new RPS regime to ensure continuity of the relevant regulations and avoid duplication of compliance efforts by designated RPS.

Consultation questions:

Q19. Do you have any comments on the proposed meanings of the terms "SO" and "SI" in relation to RPS?

Q20. Do you have any comments on the requirements to be imposed on designated RPS?

⁵ Released in January 2007 and endorsed by the HKMA, the "Code of Practice for Payment Card Schemes" was drawn up by eight credit and debit card scheme operators in Hong Kong with the objective of promoting the general safety and efficiency of payment card operations in Hong Kong. The Code is non-statutory, and the eight credit and debit card scheme operators have committed to adopt and comply with the Code.

7. HKMA's Supervisory Powers

7.1 Supervisory Powers Applicable to SVF

7.1.1 To ensure that SVF licensees will continuously meet the statutory requirements including the minimum licensing criteria and any licensing conditions specified for them in relation to their SVF business, it is necessary that the HKMA be vested with the appropriate prudential supervisory powers under the new legislative framework to, in the course of its on-site examinations, off-site reviews and prudential meetings with the SVF licensees, determine as appropriate the adequacy of their overall control environment. For this purpose, it is proposed that suitably modified versions of the relevant provisions of the BO be incorporated into the CSSAB to allow the HKMA to exercise supervisory functions over SVF licensees. It is our current thinking that to the extent that a licensed bank in Hong Kong is subject to the HKMA's supervisory powers under the BO, the HKMA's new powers under the CSSAB would, in general, not be applicable to SVF licensees which are licensed banks in Hong Kong.

7.1.2 The proposed new powers seek to empower the HKMA to:

- (a) Where the HKMA is of the opinion that the SVF licensee: i) has become or is likely to become insolvent or unable to meet its obligations; ii) is carrying on its business in a manner detrimental to the interests of its users or its creditor; iii) has contravened any of the licensing conditions or provisions of the CSSAB, or where the FS advises the HKMA that he considers it in the public interest to do so:
 - I. require a SVF licensee to do any act as the HKMA thinks necessary;
 - II. give directions to a SVF licensee to seek advice on the management of its affairs, business and property from an advisor appointed by the HKMA;
 - III. give directions that a SVF licensee's affairs, business and property must be managed by a manager appointed by the HKMA; and

- (b) examine books, accounts and transactions of a SVF licensee, and request the licensee to provide books, accounts and transactions of its subsidiary for examination.

7.1.3 It is also proposed that suitably modified version of the relevant provisions of the BO be incorporated in the CSSAB to enable the HKMA to ensure the fitness and propriety of the ownership and management of SVF licensees. Again, for the reasons set out in section 7.1.1 above, these proposed powers, generally speaking, would not be applicable to SVF licensees which are licensed banks in Hong Kong since they are already subject to the relevant provisions under the BO. The proposed powers include:

- (a) amalgamation, including any arrangement or agreement for the sale or disposal of all or part of the business of the SVF, requires the HKMA's approval;
- (b) persons becoming or being "controllers" (majority shareholder controller, minority shareholder controller, and indirect controller) and sale of shares require the HKMA's approval; and
- (c) appointment of chief executives and directors of SVF requires HKMA's approval.

7.2 Supervisory Powers Applicable to Both SVF and RPS

7.2.1 It is necessary to give certain general powers to the HKMA to perform various day-to-day supervision and oversight functions over SVF and RPS respectively under the CSSAB. The following sections set out a non-exhaustive list of such powers.

Powers to Gather Information

7.2.2 It is proposed that the HKMA be empowered to request information or documents, including reports prepared by internal and external auditors, to be furnished to the HKMA by SVF and RPS on a periodic basis or at any time as the HKMA thinks fit. The HKMA will also be empowered to conduct on-site examinations on the premises of SVF and RPS for the purpose of collecting

information to enable the HKMA to effectively monitor the compliance of SVF and RPS with the requirements of the CSSAB.

Powers to Give Directions

7.2.3 It is proposed that the HKMA be empowered to direct SVF and RPS to take such action as the HKMA considers necessary to bring the SVF and RPS into compliance with the statutory requirements of the CSSAB.

Powers to Impose Operating Rules

7.2.4 It is proposed that the HKMA be empowered to direct that the operating rules of SVF and RPS be amended in such manner as the HKMA considers necessary to bring the operating rules into compliance with the statutory requirements of the CSSAB.

Powers to Make Regulations

7.2.5 It is proposed that the HKMA be empowered to make regulations under the CSSAB for carrying out the purposes of the CSSAB effectively e.g. regulations may provide for measures to be put in place with a SVF or designated RPS for the purposes of monitoring and enforcing compliance with the operating rules of the facility or system and the provisions of the CSSAB.

Powers to Issue Guidelines

7.2.6 It is proposed that the HKMA be empowered to issue guidelines to prescribe the manner in which the HKMA will perform his functions and provide guidance on compliance of the CSSAB and to provide practical guidance to assist SVF and RPS in complying with the provisions of the CSSAB.

Consultation question:

Q21. Do you have any comments on the proposed supervisory powers of the HKMA on SVF and RPS?

8. Investigation Powers of the HKMA

8.1 Non-compliance with the proposed statutory requirements or improper operation of SVF and designated RPS may induce losses to users and participants and disruption to the payment system as well as the financial system of Hong Kong as a whole. The overall objective of enforcement functions is to identify wrongdoing efficiently and at the early stage and to bring appropriate sanctions to wrongdoers. Through taking appropriate disciplinary actions against offenders, enforcement functions serve to promote fairness in the retail payment industry, protect the users of SVF and designated RPS and minimise non-compliance. Currently, there are limited information-gathering powers under the CSSO. For this purpose, and with reference to similar powers in the SFO and AMLO, it is proposed that the HKMA be empowered to conduct investigation into all bank and non-bank SVF licensees and designated RPS where it has reasonable cause to believe that an offence under the CSSAB has been committed. It is also proposed that the same set of proposed powers will also apply to large-value clearing and settlement systems currently designated or deemed to have been designated under the CSSO. The proposed powers include the following:

- (a) the HKMA may direct an investigator to conduct investigation;
- (b) the investigator may compel provision of evidence from all persons relevant to the suspected contravention including production of any record or document. The HKMA may require the persons to explain particulars in respect of any record or document; require such person to attend before him to answer questions pertaining to the matters under investigations; and give him all assistance in connection with the investigation, etc. The investigator may also inspect records or documents taken in possessions for the purpose of investigation; and
- (c) the HKMA may apply to a Magistrate for search warrants and seizures when necessary.

Consultation question:

Q22. Do you have any comments on the proposed investigation powers of the HKMA on SVF and RPS?

9. Offences, Sanctions and Appeals

9.1 Criminal Offences and Sanctions

9.1.1 The objectives of the proposed criminal sanctions are to penalise offenders and to deter industry participants from committing similar offences. Against this backdrop, it is proposed that the existing sanctions under the BO and CSSO in relation to MPSVC and designated systems be used as a basis for sanctions under the new regime for SVF and RPS. These offences include operation of an unlicensed SVF, contravention of licensing conditions or requirements (as set out in sections 5.4, 5.5 and 6.5 above), failure to produce documents as required by the HKMA, giving of false information to the HKMA or making false entries in documents, contravention of other conditions required by the HKMA in relation to the licensing/designation regime. In determining the level of fines and length of imprisonment applicable to offences under the new regime, reference will be drawn from the relevant provisions of the BO, CSSO and SFO.

9.2 Civil and Supervisory Sanctions

9.2.1 In addition to the above, the FSTB and the HKMA are of the view that it will be prudent to introduce into the CSSO a regime to empower the HKMA to impose civil and supervisory sanctions, so that the HKMA can impose a range of sanctions proportionately in light of the severity, circumstances, or duration of a breach under the amended CSSO, as it will apply to large-value clearing and settlement systems (currently subject to regulation), SVF and RPS. This regulatory approach will be broadly in line with the SFO and AMLO, as well as the regulatory regime for intermediaries under the MPFSO. The proposed civil and supervisory sanctions in this respect include the following:

- (a) minor sanctions including caution, warning, reprimand, order to take specified action(s); and supervisory sanctions including temporary suspension, suspension or revocation of licence, or a combination of the above;
- (b) pecuniary penalty of not exceeding HKD10,000,000 or 3 times the amount profit gained or loss avoided, whichever is higher; or

- (c) any combination of the above.

9.3 Checks and Balances

9.3.1 In order to ensure that the exercise of the HKMA's power under the CSSO is subject to adequate safeguards, it is proposed that the existing appeal tribunal mechanisms under Part 4 of the CSSO be expanded to cater for appeals against the HKMA's decisions in relation to SVF and RPS, which will be prescribed in the CSSAB. Under the CSSO, the Clearing and Settlement Systems Appeals Tribunal consists of a Chairman who is appointed by the Chief Executive on the recommendation of the Chief Justice, and not fewer than two members appointed by the Financial Secretary on the recommendation of the Tribunal Chairman from a panel of persons appointed by the Chief Executive. The current thinking of the FSTB and the HKMA is that appealable decisions will include the HKMA's decisions in relation to, among others, the following: refusal to grant SVF licenses; attachment of conditions to SVF licenses; attachment of conditions to an exemption granted to a SVF issuer/facilitator; revocation and suspension of SVF licenses; objection to controllers and key personnel of SVF licensees; designation and revocation of designation of RPS; and impositions of minor and pecuniary sanctions, etc.

9.3.2 In addition, the existing Process Review Committee will continue to be in operation to review and advise the HKMA of the adequacy of the HKMA's internal operational procedures and guidelines for applying the standards and requirements to those designated systems in which the HKMA has a legal or beneficial interest.

Consultation question:

Q23. Do you have any comments on the proposed offences and sanctions provisions, in particular the minor sanctions and pecuniary penalty proposed, as well as the checks and balances?

10. Transitional Arrangement

10.1 It is proposed that the licensing regime for SVF and designation regime for RPS will commence upon gazettal of the CSSAB. With respect to SVF, it is proposed that a transitional period of 12 months starting from the commencement of the CSSAB be given to the relevant parties. It is to allow time for pre-existing SVF issuer to prepare for an application for a licence. During the transitional period, a pre-existing SVF issuer would not be held liable for contravening the regulatory requirements of issuing or facilitating the issuing of SVF without a licence provided that such pre-existing SVF issuer applies to the HKMA for a licence during the transitional period. We also understand that large SVF issuers may require more time to migrate the existing user accounts to a new account structure and float protection arrangement after they are granted the SFV licences. The HKMA will discuss with individual SFV licensees the time required on a case-by-case basis to ensure that adequate control measures are in place for the smooth and effective migration process.

Consultation question:

Q24. Do you have any comments on the proposed transitional arrangement?

11. Implementation Plan

11.1 Comments received from this consultation will be incorporated into the proposed regulatory regime for SVF and RPS where appropriate. It is our intention to conclude the public consultation in the second half of 2013. Our target is to introduce the amendment bill into the Legislative Council after considering the views and comments received from the public consultation.

Financial Services and the Treasury Bureau
Hong Kong Monetary Authority
22 May 2013