

DEVELOPMENT IN PAYMENTS REGULATION IN HONG KONG AND CHINA

The payments service industry in Hong Kong and China is set to enter a new, and more stringently regulated, era following announcements by the respective governments about their proposed regulatory reforms. The anticipated new regulations are intended to align the law with technology advancements in this rapidly evolving industry, bringing greater clarity as to the licensing and corporate establishment requirements for payment service providers entering the Greater China market. The new regulations are also intended to foster consumer confidence in innovative service offerings and encourage their development in line with other financial centres of the world.

Hong Kong

On 4 February 2015, the Clearing and Settlement Systems (Amendment) Bill (**Bill**) had its first reading in the Legislative Council. The Bill follows a three-month public consultation period conducted jointly by the Hong Kong Monetary Authority (**HKMA**) and Financial Services and the Treasury Bureau (**FSTB**) on proposals for the regulation of stored value facilities and retail payment systems.

The Bill creates a new regulatory regime by amending the Clearing and Settlements Systems Ordinance (**CSSO**), under which interbank clearing house transfer systems and some other market settlement systems in Hong Kong are regulated by the HKMA via designation.

Stored value facilities

Stored value facilities (**SVFs**) are facilities which enable users to make purchases on prepaid accounts. These may be multi-purpose (such as Octopus cards) or single-purpose (such as retail store gift cards). They may also be physical (device-based) or virtual.

At present, only device based multi-purpose SVFs are regulated in Hong Kong. Non-device based SVFs, which create arguably more of a regulatory concern, are unregulated. The Bill introduces a licensing regime for both device and non-device based SVFs. Key licensing criteria include:

- being a Hong Kong incorporated entity;
- having the issue of or facilitating the issue of SVFs as its principal business;
- having a minimum on-going capital of not less than HKD25 million;

- having in place measures that adequately protect the float (i.e. the stored value) and keeping the float separate from the issuer's other funds; and
- satisfying certain 'fit and proper' requirements (as applicable to authorised institutions under the HKMA).

Banks licensed under the Banking Ordinance will automatically be deemed licensed as SVF issuers given that they are already subject to substantial prudential requirements as a part of their authorisation to conduct banking business. There will also be a number of exemptions from the regime, including SVFs which are single-purpose, used within certain premises, or used for cash reward or bonus point schemes.

Retail Payment Systems

A Retail Payment System (**RPS**) is a system or an arrangement for the transfer, clearing or settlement of payment obligations relating to retail activities, e.g. credit card and debit card schemes.

RPSs are currently unregulated in Hong Kong. The eight payment card scheme operators have only commitments to a voluntary code of practice endorsed by the HKMA. Regulation of RPSs under the proposed regulatory regime will be by designation under the CSSO.

In brief, RPSs will be subject to designation by the HKMA if the proposed designation criteria are met. Designation of an RPS will take place if any disruptions to the RPS are likely to result in:

- monetary or financial instability, or the functioning of Hong Kong as an international financial centre being adversely affected;
- public confidence in payment systems or the financial system of Hong Kong being adversely affected; or
- day-to-day commercial activities in Hong Kong being adversely and materially affected.

It is envisaged that RPSs will cover credit card schemes, debit card schemes, large merchant acquirers, payment gateways, and mobile payments infrastructure. Point of sales systems, telecommunication systems and network infrastructure are unlikely to be caught by the new regime.

China

Under the current central bank rules, all payment card transactions in China, including debit and credit cards, are required to clear Renminbi transactions through UnionPay. The World Trade Organization (**WTO**) ruled in a complaint brought by the United States in 2012 that China unfairly discriminated against foreign electronic payment processors who wanted to process Renminbi transactions. Since then, opening up the payment clearing market has

been a WTO requirement. On 29 October 2014, the State Council released a statement (without reference to the WTO ruling) that qualified domestic and overseas enterprises are permitted to file applications for setting up bank-card clearing institutions in China (**Statement**).

The Statement remains a high level policy address and states that its objectives are to promote openness in the financial markets, to facilitate innovation in the domestic bank card and payment services market, to ensure that payment clearing companies put in place adequate risk management systems, to protect cardholders' rights and to bring about greater benefits and choice for consumers. No details as to the relevant criteria for foreign companies have been provided in the Statement.

The Statement signals the likely end of UnionPay's monopoly in the payment clearing market in China. It is expected that radical changes to the payment clearing market in China are underway, and that foreign companies such as Visa, MasterCard, American Express and JCB will be allowed to issue Renminbi-denominated credit cards in China in the near future.

However, it remains to be seen what practical changes the Statement will bring until specific regulations are introduced by the relevant agencies in China. Until then, the Statement remains a macro policy without clarity as to its practical impact on the market.

We will continue to monitor developments in Hong Kong and China and provide our clients with updates. In the meantime, if you would like further information on payment systems regulation in Asia or elsewhere, our Technology team would be pleased to hear from you.

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