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Commentary

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Hong Kong Closer to Complete Overhaul of Regulatory Regime for Payment Systems

On 23 January 2015, and following a lengthy consultation process, the Legislative Council of Hong Kong published the Clearing and Settlement Systems (Amendment) Bill 2015 (the "Bill") which proposes a new regulatory regime for stored value facilities (SVF) and retail payment systems (RPS) in Hong Kong. This article provides a high-level overview of some of the proposed changes to Hong Kong's payments regulatory landscape.

Glossary

- **Multi-purpose stored value cards (MPCs):** Multi-purpose stored value facilities (SVFs, defined below) are used as a means of payment for goods and services which are offered by a card issuer and other participating third parties. Hong Kong's Octopus card is an example of an MPC.
- **Non-device based SVFs:** These have their stored value on a computer or mobile network-based account instead of on a physical device. For example an electronic wallet is a non-device based SVF.
- **Retail payment system (RPS):** An RPS is a payment system that usually handles the transfer, clearing and settlement of small-value transactions, *e.g.* credit card schemes and debit cards.
- **Single purpose SVFs (SPSVFs):** These can only be used to purchase goods and services offered by the issuer of the SPSVF, for example, a card issued by a coffee chain which can only be used to buy coffee from that chain.
- **Stored Value Facility (SVF):** Generally, means a facility (other than cash) which can be used for storing a sum of money paid into it and used to pay for goods and services or for payment to another person. There are two types of SVFs; device-based (*e.g.* store cards) and non-device-based (*e.g.* electronic wallets).

Current regulation of MPCs, SVFs and RPS

Multi-purpose stored value cards (MPCs)

Under The Banking Ordinance (Cap. 155) (BO) the Hong Kong Monetary Authority (HKMA) has the power to regulate the issue of MPCs in Hong Kong. For example, Octopus, the smart card payment system, is authorised by HKMA as a deposit taking company. Banks, under the BO, are deemed to have approval to issue MPCs. The BO does not regulate single purpose value cards (*e.g.* stored value cards issued by a coffee chain which can only be used to purchase the issuer's products and services).

Non-device-based SVFs

MPCs are device-based SVFs, however, non-device-based SVFs — which have their stored value on a computer or mobile network based account instead of on a physical device — are not currently subject to any regulation. The lack of regulation of these payment systems and services puts Hong Kong's payments legislation out of sync with those of other major financial centres such as the UK and Singapore. These jurisdictions both have established legislation regulating non-device-based SVFs.

Retail Payment System (RPS)

HKMA requires that RPSs such as credit and debit card schemes self-regulate. This informal approach is largely targeted at payment cards and the eight payment card scheme operators (which include VISA, Mastercard, Amex, etc.) have adopted a voluntary code of practice endorsed by HKMA.

Key proposed changes to the regulatory regime

Key Features	Commentary
MANDATORY LICENSING SYSTEM FOR SVFS	
• Licensing scheme will capture both device-based and non-device-based SVFs. Note, in line with existing regulation of MPCs, banks will be deemed licensed to issue SVFs.	• This would bring the regulation of SVFs on par with, and even surpassing in some cases, the regulation of other financial centres. For example, whilst Singapore's legislation captures both device-and non-device-based SVFs, Singapore does not have a mandatory licensing system for SVFs.
• **Definition of SVF:** Unless otherwise excluded, a facility is a SVF if it can be used for storing a sum of money paid into it and can be used as a means of payment for goods and services.	• This broad definition will capture many different payment systems. However, the Hong Kong government has stated that the regulatory regime will exclude air miles schemes, loyalty cards, etc., and SVFs issued by a 'single online store platform'. A single online store platform is a platform which issues prepaid cards or coupons for the purpose of purchasing digital content such as games, apps and movies. These exclusions are in line with one of the policy objectives behind the proposed regulatory regime — encouraging innovation in retail payment products and services.
• Single purpose SVFs (SPSVFs) will not be regulated.	• SPSVFs will be excluded because they are not considered to pose a significant risk to the payment and financial systems of Hong Kong.
• Licensing criteria include: (a) that the company must have a physical presence in Hong Kong, (b) that the principal business must be the issue of, or facilitating the issue of, SVF under license, and (c) a minimum paid up share	• Some commentators have raised concerns that a minimum share capital of HK$25 million will act as a barrier to entry for smaller companies. However, the Hong Kong government intends that the HK$25 million

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capital requirement of not less than HK$25 million.	capital requirement will act as a buffer to absorb unexpected losses.
• Applicants will have to present their business plan to HKMA for approval. HKMA can attach conditions to the licence, including conditions relating to maintenance of the float (see key feature below). • It will be a criminal offence to issue, or facilitate the issue of, SVF without having a license. Anyone convicted on indictment will be liable to pay a fine of HK$1 million and to imprisonment for 5 years.	• The Hong Kong government has explained that the purpose of attaching separate conditions to each licence is to ensure the soundness of the payment scheme.
FLOAT	
• The float is the total sum of money holders pay to the issuer of the SVFs. Both banks and non-bank SVF licences will need to (i) have measures in place to protect the float, and (ii) keep it separate from the other funds.	• The initial proposal made by the government was that licensed banks would be deemed licensed to issue SVFs and that licensed banks which held SVF licences would not be required to safeguard the float. The reasoning behind this was that banks are already subject to strict regulatory requirements, including with respect to their liquidity and capital. Commentators argued that this proposal would provide banks with a competitive advantage over non-bank-SVF issuers. Whilst the Hong Kong government has maintained the position that banks will not need to apply for a licence, it has changed its position on the float.
MAXIMUM STORED VALUE	
• Device-based SVFs will be subject to a maximum stored value of HK$3,000 (approx. SGD$500 or USD$386). Whereas non-device-based SVFs may have individual limits placed on them under the terms of the licence.	• Currently, Hong Kong's anti-money laundering laws on record keeping and due diligence requirements do not apply to MPCs with maximum values capped at HK$3,000. The initial proposal to extend this exclusion to non-device-based SVFs received criticism from commentators that the threshold was too low given that these SVFs are often used for both making and receiving payments. The Hong Kong government took this on board and has backed away from a general threshold and will make individual assessments.

Key Features	Commentary
RPS	
• A designation scheme will be established which will enable HKMA to designate a system as an RPS if disruptions to the RPS would have an impact on (i) the monetary or financial stability of Hong Kong, (ii) public confidence in payment systems or the financial systems of Hong Kong, or (iii) public confidence in day-to-day commercial activities in Hong Kong. Once designated, an RPS would be subject to safety and efficiency requirements which are similar to those already existing in the Clearing and Settlement Systems Ordinance.	• The Bill does not set out specific criteria which would be used to designate an RPS. The Bill provides that HKMA can designate a system as an RPS in order to impose various requirements over them. However in the government's conclusions on the consultation process the government confirmed that HKMA would develop supervisory guidelines in relation to the designation process. • When those criteria are published we will have a clearer understanding of which RPSs would likely be caught by the scheme. However, the Hong Kong government did confirm that it does not intend to designate online banking services and shared ATM networks because these RPS are already subject to HKMA regulation. The government also confirmed that it does not intend to designate telecommunication and network infrastructures systems. The government noted increasing levels of acceptance for mobile payment systems, such as NFC (near field communication) and confirmed that it does not intend to designate such systems, but expects operators to ensure that such systems are reliable and safe. The suggestion is that this kind of latest technology in payment systems will be subject to an informal self-regulatory approach; this works well with fostering innovation in payment systems.

Next steps

On 4 February 2015 the Bill will begin its journey through Hong Kong's legislative procedures. However, there is no indication of when the Bill is expected to pass into law. The Bill proposes implementing the new provisions in two phases and offers existing SVF issuers a one year transitional period within which to apply for and obtain a license from HKMA.

Conclusion

The payments systems regulatory landscape in Hong Kong is set to significantly change and a large number of industry players are likely to be affected. The recently published Bill indicates that the Hong Kong government has not lost sight of the objectives behind the proposals which include fostering innovation in retail payment products and services along with maintaining its status as a key international financial centre. Assuming the Bill passes into law, the regulation of payments in Hong Kong will change dramatically.

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