

# Aligning the law with innovative payments in Hong Kong

In light of recent developments in innovative payment methods, a new proposed regulatory regime has emerged in Hong Kong. The Financial Services and Treasury Bureau ('FSTB') and the Hong Kong Monetary Authority ('HKMA') plan to align the legal framework in Hong Kong with emerging payments systems. Gabriela Kennedy, a Partner at Mayer Brown JSM, provides an outline of the proposals made by the FSTB and HKMA.

## Emergence of new payment methods

New ways of paying for goods and services, such as mobile payments and mobile network-based accounts, are becoming increasingly popular due to technological developments such as Near Field Communication and the increasing popularity of smartphones and tablets, which enable e-commerce transactions on the go. These payment methods are generally known as stored value facility ('SVF') and retail payment system ('RPS').

An SVF essentially involves the pre-payment to or storage of the value of money (or money's worth) on a payment facility, such as a gift card or a top-up card. SVFs can generally be categorised as: (i) single-purpose SVFs or multi-purpose SVFs; and (ii) device based (where the stored value is on a physical device, e.g. a card) or non-device based (where the stored value is on non-physical devices, e.g. mobile network accounts). A single-purpose SVF can only be used to obtain goods or services from the sole merchant who issued the SVF, e.g. a prepaid card issued by a supermarket to purchase goods from its supermarkets. In contrast, a multi-

purpose SVF (such as an Octopus card in Hong Kong) can be used to obtain goods or services from multiple merchants (convenience stores, supermarkets, cinemas, transport companies).

An RPS is essentially a system for the transfer, clearing or settlement of low-value payments in relation to retail purchases, e.g. mobile payments.

## The new legal framework

Whilst device-based multi-purpose SVFs are currently regulated in Hong Kong under the Banking Ordinance ('BO'), non-device based SVFs and RPSs are not subject to any mandatory regulations under Hong Kong law (though a self-regulatory regime is in place for payment cards under a voluntary code of practice). Concerns have therefore been raised that the current laws do not provide the public with adequate protection for the secure and safe operation of such payment transactions. In other countries, e.g. the UK and Australia, regulations have already been enacted that generally impose licensing requirements on entities offering SVFs and grant the right to local authorities to designate and oversee important RPSs.

On 22 May 2013, the Financial Services and Treasury Bureau ('FSTB') and the Hong Kong Monetary Authority ('HKMA') issued a public consultation paper to invite comments on their proposed introduction of a regulatory regime for SVFs and RPSs. The consultation period expired on 22 August 2013. Based on the public's feedback, a new amendment bill will be introduced to the Legislative Council to amend the existing Clearing and Settlement Systems Ordinance ('CSSO').

The main proposals are as follows:

- a licence must first be obtained from the HKMA before a person can issue or facilitate the issuance of an SVF;
- the HKMA will designate the RPSs that will be subject to the HKMA's oversight;
- the HKMA will have the power to conduct on-going supervision of SVF licensees and designated RPSs;
- the HKMA will have the power to perform investigations and enforcement functions;
- offences, sanctions and appeal processes will be introduced; and
- a 12 month transition period for existing SVFs to move to the new regulatory regime.

## SVF licensing regime

The definition of a SVF under the proposed amendments has been broadly drafted to capture any new SVF developed in the future, and applies to both device and non-device based SVFs.

However, the proposed definition expressly excludes single purpose SVFs. As such, only issuers (or those who facilitate the issuance) of multi-purpose SVFs, and not single purpose SVFs, will need to obtain a licence. The HKMA will also have the discretion to exempt certain SVFs from the licensing requirements if, for example, there is minimal risk to users or it would have an insignificant impact on Hong Kong's financial stability.

Licensed banks will be deemed to have a SVF licence and will therefore not have to go through the process of obtaining a SVF licence.

In order to obtain a licence, a licensee must satisfy (and continue to satisfy) certain criteria, including the following:

- it must be incorporated in Hong Kong with a local registered office, i.e. a foreign company with a Hong Kong branch cannot apply;
- it must maintain a paid-up share capital of HK\$ 25,000,000 or



over;

- it must put in place policies and procedures to safeguard and manage the 'float' (the total amount received by the licensee for storage on the SVF);

- it must redeem the full value stored on the SVF at the user's request, and must clearly state the terms and conditions for redemption in the user contract;

- its main business must be the issuance of (or facilitating the issuance of) multi-purpose SVFs;

- its managers must have the appropriate knowledge and experience in providing SVFs and related services;

- its officers responsible for implementing or day-to-day management of the SVF must have the necessary knowledge and experience to discharge those responsibilities effectively;

- its shareholders who meet the specified threshold must be fit and proper persons; and

- other conditions, such as anti-money laundering requirements, risk management requirements and operating rules.

In addition, the HKMA may also impose other on-going conditions on the licensee, e.g. a maximum amount that may be stored on the SVF and a daily transaction limit.

Lastly, the proposed legislation aims to offer better protection of the 'float' of SVFs. SVF licensees who are not licensed banks will be required to keep the float separate from their other funds and must subject the float to safeguard measures, e.g. a guarantee from or a trust account with a Hong Kong bank. The HKMA will determine via discussions with each licensee what those measures will be. In contrast, licensed banks will simply need to ensure that they have in place sufficient controls to protect the float, which the HKMA will review continuously to ensure adequacy.

**The HKMA will also have the discretion to exempt certain stored value facilities from the licensing requirements if, for example, there is minimal risk to users or it would have an insignificant impact on Hong Kong's financial stability.**

#### RPS designation

The proposed amendments will give the HKMA the power to designate RPSs that are to be monitored by the HKMA. An RPS would only be designated if:

- it is operated in Hong Kong, or processes Hong Kong dollars or any other currencies prescribed by the HKMA; and

- the disruption of the RPS would have an impact on the financial stability of Hong Kong; public confidence in the payment or financial systems of Hong Kong; or day-to-day commercial activities in Hong Kong.

Any RPS designated by the HKMA will have to comply with certain safety requirements. For example, designated RPSs must:

- have proper operating rules in place to ensure the soundness of the systems operations, default arrangements, etc.;

- have measures to ensure data integrity, a contingency plan and risk management controls; and

- comply with the Hong Kong Anti-Money Laundering Ordinance.

Certain designated RPSs may be exempted from some of these obligations if the RPS is established outside of Hong Kong and is already subject to sufficient supervision by its local regulator.

#### Investigation, enforcement, offences and sanctions

The HKMA will have the general power to issue guidelines or new regulations; request documents or information; conduct on-site inspections; direct that operating rules be amended; and issue directions.

Where the HKMA believes that an offence has been committed, the HKMA will also have the power to direct an investigator to conduct an investigation; to compel the

provision of any evidence from the alleged offender; and to also apply for search warrants and seizures.

A person will commit an offence if they operate an SVF without a licence; contravene an SVF licensing condition or other conditions imposed on a licensed SVF or designated RPS; give false information to the HKMA; fail to produce documents requested or make false entries into the documents. It is proposed that the criminal sanctions currently in place under the BO and CSSO be used as the basis for determining the sanctions to apply to the new regime.

In addition, the HKMA will have the right to impose certain sanctions, including the suspension or revocation of a licence; the issuance of a warning, or a pecuniary penalty of up to HK\$ 10,000,000 or three times the profits gained or loss avoided.

Aggrieved persons will be able to appeal some of the HKMA's decisions (e.g. refusal to grant an SVF licence) by applying to the new Payment Systems and Stored Value Facilities Appeals Tribunal (currently the Clearing and Settlement Systems Appeal Tribunal).

**Gabriela Kennedy** Partner  
Mayer Brown JSM  
gkennedy@mayerbrown.com