Hong Kong's proposed new payments regulatory regime

The rise of new methods of payment in Hong Kong ('HK') has led to the proposal by the Financial Services and Treasury Bureau ('FSTB') and the HK Monetary Authority ('HKMA') of a new regulatory regime, outlined in a consultation paper issued on 22 May 2013. On 31 October 2014, the FSTB and HKMA issued the consultation's conclusions. Gabriela Kennedy and Karen H.F. Lee of Mayer Brown JSM discuss the conclusions drawn.

The FTSB and HKMA invited comment on introducing a new legal framework to regulate stored value facilities ('SVFs') and retail payment systems ('RPSs'). An RPS is a system for the transfer, clearing or settlement of low value payments for retail purchases, e.g. mobile payments etc. An SVF involves the pre-payment to or storage of money on a payment facility, e.g. a gift card. An SVF can be categorised as: (i) a single-purpose SVF (only used to purchase goods or services from one merchant, e.g. a gift card) or a multi-purpose SVF (for obtaining goods or services from multiple merchants); and (ii) device based (where value is stored on a physical device) or non-device based.

Currently, only multi-purpose device based SVFs are regulated under the Banking Ordinance. Similarly, RPSs are not regulated but a voluntary 'Code of Practice for Payment Card Scheme Operations,' which sets out general principles to promote safety and efficiency of payment card operations, was adopted by eight card operators in 2007 and endorsed by the HKMA. Under the proposed regulatory regime set out in the Paper both device based and non-device based SVFs and RPSs will be regulated via amendments to the current Clearing and Settlement Systems Ordinance ('CSSO'), and the existing multi-purpose SVF regime under the Banking Ordinance will be migrated to the CSSO. In short, the Paper proposed that[1]:

(1) all issuers of multi-purpose SVFs must obtain a licence from the HKMA before issuing the SVF;

(2) single-purpose SVFs would not be regulated;

(3) licensed banks in HK will be deemed to already have a licence to issue multi-purpose SVFs;

(4) other issuers of multi-purpose SVFs would be required to keep the float separate from their own funds and fully protected by safeguarding measures;

(5) the HKMA would have the power to designate certain types of RPSs to be subject to its continuous oversight;

(6) an RPS would be designated for oversight if: (i) it is operated in HK or processes HK dollars or other currencies prescribed by the HKMA; (ii) the disruption of the RPS's business would have an impact on HK's financial stability, day-to-day commercial activities, or would undermine public confidence in HK's payment or financial systems; and

(7) if the HKMA believes that an offence has been committed under the new regime (e.g. a person has operated an SVF without a licence etc.), the HKMA can direct an investigator to investigate; compel the provision of evidence by the alleged offender; and apply for search/seizure warrants.

The consultation conclusions

The FTSB and HKMA (the 'government') received 41 submissions from market players and government bodies, including the Consumer Council, Alipay, PayPal and KPMG, summarised in the conclusions. The submissions indicate overall support for the policy objectives and proposals in the Paper. Most of the market players and government bodies that submitted a response believe introducing a regulatory regime will further foster the development of retail payment products and services and encourage user confidence. However, concerns were raised regarding elements of the proposal.

Licensed banks deemed to have an SVF licence

The Paper proposed that licensed banks would be deemed to be licensed for multi-purpose SVFs and would not be required to ensure that the float is kept separate, nor required to implement certain safeguarding measures to protect it. Some non-bank respondents felt this gave banks a competitive advantage and that all players should be subject to the same requirements, to maintain market consistency and a level playing field.

The proposal that licensed banks will be deemed to be licensed to issue SVFs has been maintained. The rationale is that licensed banks are already subject to stringent requirements and HKMA supervision. However, to ensure consistency, the government agreed that SVF licencees should be required to observe the same float safeguarding principles: (a) to have in place adequate float protection measures; and (b) to keep the float separate from other funds. An SVF issuer will need to demonstrate their safeguarding measures to the HKMA's satisfaction.

Definition of SVFs and the scope of application

The Paper proposed that the definition of SVFs should include 'money's worth,' so it would capture the concept of 'value,' i.e.

real money and other forms of monetary consideration that can be redeemed by an SVF user, or value added into an SVF account by a user or received from another person. Some responses raised concerns that too broad a definition would encompass things such as: (a) air mileage schemes, loyalty schemes and bonus points schemes; and (b) prepaid cards or coupons issued by a single online platform, which are used to purchase digital products, whose IP is owned by different third parties. Such items should not be captured by the regulatory regime as they pose minimal risk to users.

The government proposed further amendments to the definition of SVFs to exclude: (a) any bonus/loyalty point scheme; (b) any facility that can be used within one or more of the issuer's premises, so long as the total float does not exceed HK $1 million; and (c) any facility which can only be used within specified premises and which relates to a specific person (e.g. recreational clubs) and the total float size does not exceed HK $1 million.

Separate SVF licences for issuers and facilitators

The Paper proposed that separate licences would need to be obtained if a company wished to issue SVFs and to facilitate the issuance of SVFs. A few responses noted that a company licensed to issue SVFs should not have to apply separately to facilitate the issuance of SVFs, and vice versa. The government has agreed to unify the licensing process so companies only need one licence to be able to act as an SVF issuer and facilitator.

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Maximum value stored on SVFs

The Paper proposed that the maximum amount that can be stored on a multi-purpose SVF is HK $3,000. The concerns were that this was too low in relation to non-device based SVFs, which normally involve the receipt of money as well as payment making. Some respondents suggested that a risk based approach should be adopted in respect of non-device based SVFs. In response, the government has agreed that the limit should only apply to device based SVFs. A risk-based approach to be assessed on a case-by-case basis should be adopted for non-device SVFs.

Single-purpose SVFs

The Paper proposed that single-purpose SVFs would not be subject to the regulatory regime. A few respondents noted that single-purpose SVFs should be regulated, as some single-purpose SVFs may accumulate a substantial float received from many users. The government maintained the original position, as these SVFs pose limited risk to consumers and regulation would stifle innovation.

Physical presence in Hong Kong and minimum capital

The Paper proposed that applicants would be required to meet certain conditions to obtain and maintain an SVF licence. These include having a physical presence in HK, the principal business being the issuance of or facilitating the issuance of SVFs, and a minimum on going capital requirement of at least HK $25 million. Such requirements do not take into account the fact that some overseas SVF issuers are already subjected to sufficient supervision at home and can show they have adequate float safeguarding measures. They should therefore be exempt from the requirement to have a local presence in HK and to comply with the float safeguarding requirements. Views were also expressed that the minimum HK $25 million on going capital requirement was too high. Given that the intention was to ensure that the HKMA can exercise day-to-day supervision over the issuers, and they should exist as stand alone entities separate from their affiliated overseas businesses, these concerns were not entertained. The HK $25 million threshold was also considered to be consistent with the current multi-purpose SVF regime under the Banking Ordinance.

Designating RPSs

The Paper proposed that the HKMA would have the right to designate the RPSs to monitor. In HK, there is voluntary self-regulation of RPSs. The Paper envisaged the HKMA would have the power to designate RPSs to regulate and such regulation would be derived from the existing rules under the CSSO. Concerns were expressed that subjecting credit card schemes to the RPS regulatory framework would undermine HK's status as an international financial centre, and that self-regulation by payment card operators is sufficient. The government was not persuaded and the original proposal will be maintained.

The way forward

A bill to amend the CSSO is being drafted to be introduced to Legislative Council in the 2014-2015 legislative session. The government has suggested that once this bill is enacted, a transitional period of 12 months will enable existing SVF issuers to apply for SVF licences.

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1. For a more detailed analysis of the new legal regime proposed by the FSTB and HKMA, please see the author's article in *E-Finance & Payments Law & Policy*, Volume 7, Issue 10 (October '13).