

**Business Facilitation Advisory Committee
Wholesale and Retail Taskforce**

**Regulatory Regime for
Stored Value Facilities and Retail Payment Systems**

Purpose

This paper provides members with information on the regulatory regime for stored value facilities¹ (SVF) and retail payment systems² (RPS) under the Payment Systems and Stored Value Facilities Ordinance (Cap. 584) (“PSSVFO”).

Background

2. The global retail payment market has been developing rapidly. Technological advancements and increasing acceptance of new technologies by the public have led to the emergence of new forms of retail payment products and services such as stored value payment cards; online stored value payment facilities; and Internet or mobile payment services, etc. In Hong Kong, there has been a notable growth in such products and services being offered to the public in recent years.

3. Prior to the enactment of the PSSVFO, the regulatory regime for stored value cards was provided in the Banking Ordinance (“BO”) (Cap. 155) which only applied to device-based multipurpose stored value products. The

¹ SVF means a facility which (a) is used for storing the value of a sum of money that is paid into the facility from time to time under the rules of the facilities; and (b) is used as a means of making payment for goods or services under an undertaking given by the issuer of the facility, and/or as a means of making person-to-person payments. Examples include the Octopus Cards and the increasingly popular online stored value payment facilities.

² RPS means a system or an arrangement for the transfer, clearing or settlement of payment obligations relating to retail activities, principally by individuals, that involves purchases or payments, and includes the related instruments and procedures. RPS generally covers credit and debit card schemes, electronic funds transfer systems, transaction acquiring systems, and payment gateways, etc., in which the payment systems do not hold accounts for maintaining funds for users.

Clearing and Settlement Systems Ordinance (“CSSO”), which was retitled PSSVFO) also provided a legal framework for the Hong Kong Monetary Authority (“HKMA”) to designate and oversee large-value clearing and settlement systems such as the Real Time Gross Settlement systems. Nonetheless, neither did the regulatory regime in BO nor the then CSSO cover non-device-based stored value payment facilities (which store value on network-based accounts, mobile network accounts or computer servers and are usually issued by non-bank institutions) and payment systems related to retail activities.

4. In light of the above, it was considered necessary to expand the existing regulatory regimes to cover both device-based and non-device-based SVF and important RPS to ensure their safety and soundness in so far as they relate to the financial stability of Hong Kong. Accordingly, the HKMA introduced legislative proposals in 2013 to amend the CSSO, the BO and other relevant legislations to establish a new regulatory framework for SVF and RPS with the following policy objectives:

- (a) to ensure the safety and soundness of the operation of SVF and RPS;
- (b) to ensure adequate protection of the float³ 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 international financial centre by upgrading the retail payment legislation in line with what major financial centres are pursuing.

5. The legislative proposals were passed by the Legislative Council and the PSSVFO commenced operation on 13 November 2015, under which the HKMA is empowered to:

³ “Float” refers to the total sum of money paid by an SVF user to an SVF issuer, including any other sums of money received on the account of the user, for storage on SVF. The “float” of an SVF is outside the definition of “deposit” under the BO and the Deposit Protection Scheme Ordinance.

- (a) implement a mandatory licensing regime for multi-purpose SVF and perform relevant supervisory and enforcement functions; and
- (b) designate important RPS in Hong Kong and perform oversight on the safety and efficiency of their operations.

Regulatory Framework for SVF

6. The primary regulatory concern of SVF stems from the need to protect SVF users' float maintained by SVF issuers. To ensure the safety and efficiency of SVF issuers' operation and proper protection of the float, a mandatory licensing regime for SVF is implemented to the effect that no person may issue SVF in Hong Kong without a licence granted by the HKMA. Any person who contravenes such requirement commits an offence. Licensed banks under the BO are deemed to be licensed to issue SVF. As such they are not required to go through the licensing process under the PSSVFO. The reasons for giving licensed banks a deemed licensed status is that they are already subject to stringent regulations including authorization process and on-going supervision by the HKMA on a holistic basis. However, they are still required to comply with the relevant provisions under the PSSVFO which are applicable to licensed banks should they decide to embark on an SVF business.

7. The SVF licensing regime covers both device-based and non-device-based multi-purpose SVF. Single-purpose SVF⁴ are not subject to regulation as they are essentially bilateral contractual arrangements between service vendors and their respective users for advance payment for specific goods or services. Given its bilateral nature, the degree of "moneyness" entailed by single-purpose SVF is minimal, therefore posing immaterial risks to the payment and financial systems of Hong Kong.

8. The new SVF regime also provides for certain SVFs to be exempt from the licensing requirements. Such exemptions apply to loyalty and bonus point schemes with cash reward or involving limited users' cash elements, single online store platform, as well as SVF with limited usage (say,

⁴ Single-purpose SVF is used as a means of payment for goods or services provided by the issuer of the SVF only (e.g. prepaid coupons issued by cake shops or coffee shops).

those used within limited group of goods or service providers, or within certain premises) and a float size of not more than HK\$ 1 million. Under the PSSVFO, the HKMA may also exempt an SVF from the regulatory regime, having regard to the materiality of the risk it poses to the users or potential users and the payment or financial systems in Hong Kong.

9. The licensing criteria for multi-purpose SVF as provided by the PSSVFO include the following:

- (a) The SVF issuer must be a body corporate under Hong Kong law and physically present in Hong Kong;
- (b) The principal business of the SVF issuer must be the issuing of and/or facilitating of the issue of SVF;
- (c) The SVF issuer must have paid-up share capital of no less than HK\$ 25 million;
- (d) Officers and controllers of the SVF issuer must be “fit and proper” persons and possess adequate relevant knowledge and experience;
- (e) The SVF issuer must have in place appropriate risk management policies and procedures for managing the risks arising from the operation of its SVF scheme
- (f) The SVF issuer must have in place adequate systems of control for preventing or combating possible money laundering or terrorist financing;
- (g) The SVF issuer must have in place adequate risk management policies and procedures for managing the float;
- (h) The SVF issuer must redeem in full the value stored in an SVF upon receiving a redemption request from a user; and
- (i) The SVF scheme and its operating rules must be prudent and sound.

10. The PSSVFO provides for a one-year transitional period from 13 November 2015 for existing SVF issuers or new market operators to apply for a licence from the HKMA and continue their operations. Upon the completion of this one-year period on 12 November 2016, SVF issuers must have obtained an SVF licence pursuant to the PSSVFO in order to launch or continue their SVF operations. The purpose of implementing the new regime by phases is to allow sufficient time for the applicants to prepare the required documentations and for the HKMA to process the applications. Also, since some service providers have been offering services to their users, this arrangement can avoid disrupting their normal operations and services to the public.

11. Following the commencement of the PSSVFO in November last year, over 20 prospective applicants have approached the HKMA indicating interest for SVF licence. Among them, around one-third are new market entrants and some are start-up companies. HKMA has been engaging in close dialogues with these prospective applicants and has issued guidance documents to set out the licensing requirements as well as our regulatory expectations to facilitate licence applications.

Regulatory Framework for RPS

12. Safe and efficient functioning of widely-used RPS is essential to the smooth running of day-to-day economic activities in Hong Kong. Any disruptions to an 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. To ensure the safety and efficiency of RPS, the PSSVFO empowers the HKMA to designate certain RPS for regulatory oversight. An RPS which operates in Hong Kong or processes retail payment transactions denominated in Hong Kong dollar or other currencies or a declared medium of exchange⁵ may be designated if any disruptions to the RPS are likely to result in any of the following:

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

⁵ Under the PSSVFO, the HKMA may declare by notice in the Gazette a thing to be a medium of exchange for the purposes of the Ordinance.

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

13. In applying the above proposed designation criteria, the HKMA may take into account factors including: (i) the estimated aggregate value of orders transferred, cleared or settled through the system; (ii) the estimated average value of orders transferred, cleared or settled through the system; (iii) the estimated number of orders transferred, cleared or settled through the system; (iv) the estimated number of participants of the system; and (v) any direct or indirect interfaces to other designated payment systems.

Supervision of SVF Licensees and Oversight of Designated RPS

14. Under the PSSVFO, it is the functions of the HKMA to, among others: (i) monitor compliance with the obligations imposed under the PSSVFO in relation to SVF and designated RPS; (ii) promote the general safety and efficiency SVF and designated RPS; (iii) take reasonable steps to satisfy itself that SVF and designated RPS are operated in a safe and efficient manner; (iv) promote and encourage proper standards of operation and sound and prudent practices amongst SVF and designated RPS; (v) cooperate with and assist recognized financial services supervisory authorities in maintaining and promoting safety and efficiency in the operations of SVF and designated RPS; and (vi) consider and propose reforms of the law related to operations of SVF and designated RPS.

15. In discharging its supervisory and oversight functions over SVF and designated RPS, the HKMA deploys an array of supervisory tools which include, among others: (i) off-site reviews and continuous monitoring through review of regular returns on financial positions, system performance and various management information as well as incident reports, etc.; (ii) regular and ad hoc on-site examinations based on findings from off-site review and risk profile of regulatees; (iii) independent assessments or audits where necessary; and (iii) regular meetings with management of the regulatees.

16. Members are invited to note the contents of the paper and offer comments, if any.

Hong Kong Monetary Authority
June 2016