FEATURE ARTICLE

Implementation of the Stored Value Facilities Regulatory Regime

by Monetary Management Department

The global retail payment landscape has been developing rapidly. Technology advancements have led to the emergence of new retail payment products and services. In Hong Kong, there has been a notable growth in such products and services being offered to the public in recent years. This article describes the new regulatory framework for stored value facilities under the Payment Systems and Stored Value Facilities Ordinance (Cap. 584) and the Hong Kong Monetary Authority's approach in implementing the relevant regulatory requirements.

Background

The Payment Systems and Stored Value Facilities Ordinance (Cap. 584) (PSSVFO) commenced operation on 13 November 2015. 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 multipurpose stored value cards[1]. The Clearing and Settlement Systems Ordinance (CSSO) also provided a legal framework for the Monetary Authority to designate and oversee large-value clearing and settlement systems such as the Real Time Gross Settlement systems and securities settlement systems. However, neither the regulatory regime under the BO nor the CSSO covered non-device-based stored value payment facilities (which are commonly issued outside the banking sector, and store value on network-based accounts, mobile network accounts or computer servers) and retail payment systems (RPSs).

In light of this, it was considered necessary to expand the existing regulatory regimes to cover non-device based stored value facilities (SVFs) as well as RPSs to ensure their safety and soundness. Accordingly, the Hong Kong Monetary Authority (HKMA) together with the Government and the Department of Justice introduced legislative proposals to amend the CSSO, the BO and other relevant legislations to establish a new regulatory framework for SVFs and RPSs with the following policy objectives:

(a) to ensure the safety and soundness of the operation of SVFs and RPSs;

(b) to ensure adequate protection and no misappropriation of users' float;

(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 to bring it in line with what other major financial centres are pursuing.

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1 "Stored value card" is defined in section 2 of the BO. In gist, a stored value card refers to a physical device, often in the form of a plastic card, issued by its issuer to the user as a payment means on which value can be stored.

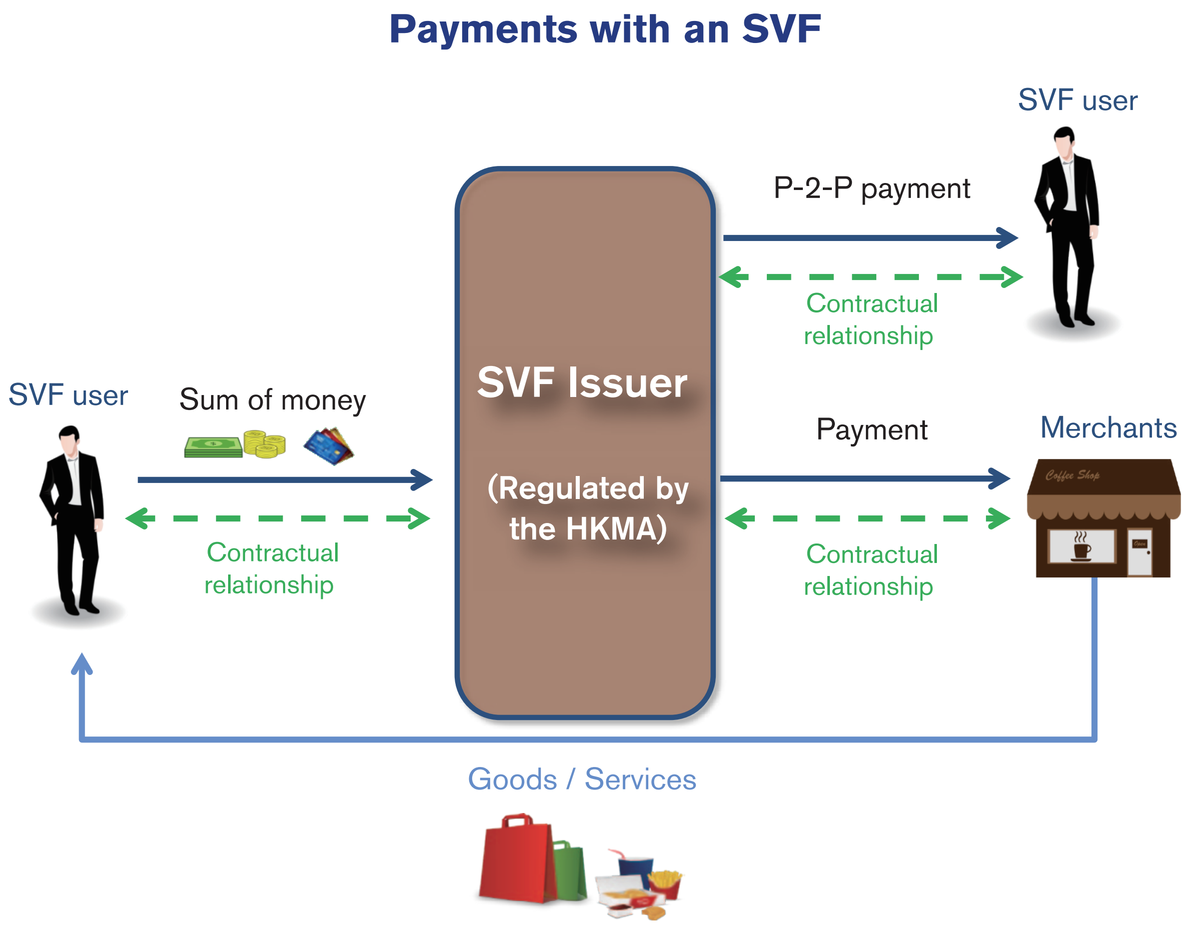
The legislative proposals were submitted to the Legislative Council in February 2015 and subsequently passed into law in November 2015. The PSSVFO was enacted accordingly, empowering the HKMA to, among other things, implement a mandatory licensing regime for multi-purpose SVFs and perform relevant supervisory and enforcement functions. This article focuses on the SVF regulatory regime under the PSSVFO.

Definition of SVF

Pursuant to section 2A of the PSSVFO, a facility is an SVF if: (a) it may be used for storing the value of an amount of money that is paid into the facility from time to time, and may be stored on the facility under the rules of the facility; and (b) it may be used as a means of making payments for goods or services and/or as a means of making payments to another person under an undertaking given by the issuer.

The definition of SVF covers both device-based and network-based SVF. For a device-based SVF, the value is stored in an electronic chip on a physical device such as plastic cards, watches and keychains. For a network-based SVF, the value is stored on a network-based account which can be accessed through the internet, a computer network or mobile network, etc. Examples of network-based SVFs include internet and mobile payment platforms that provide "network-based accounts" on which users can store value for making retail payments for online purchases, or for person-to-person funds transfers.

The following diagram depicts a typical transaction flow of payments with an SVF:



Single-purpose SVFs do not fall within the definition of SVFs for the purpose of the SVF regime. A single-purpose SVF refers to a facility which can only be used as a payment means for goods and services provided by the issuer of the facility. Single-purpose SVFs are common in Hong Kong and take a variety of forms such as prepaid coupons issued by cake shops. Since single-purpose SVFs are essentially bilateral contractual arrangements between providers of goods or services and their customers for advance payment for specific goods or services, the degree of "moneyness" entailed by such facilities are minimal and the risks of them posing material risks to the payment and financial systems of Hong Kong are relatively minimal. Incorporation of such facilities into the regulatory regime is therefore considered not necessary. This is also in line with the existing multipurpose stored value cards regime under the BO as well as practices adopted by other jurisdictions.

SVF Licensing Regime

The primary regulatory concern of SVFs stems from the need to protect SVF users' float[2] maintained by SVF issuers. To ensure the ability and competence of SVF issuers and the proper protection and management of the float, a mandatory licensing regime for SVFs under the PSSVFO has been implemented requiring any SVF issuer in Hong Kong to obtain a licence from the HKMA. It will be a criminal offence to issue SVFs or operate SVF business without a licence.

Licensed banks under the BO are regarded as being licensed to issue SVFs and are not required to go through the SVF licensing process under the PSSVFO. The reason is that licensed banks are already subject to stringent regulations including authorization process and ongoing supervision on a holistic basis by the HKMA under the BO. However, they are still required to comply with relevant provisions under the PSSVFO which are applicable to licensed banks should they decide to embark on an SVF business.

Schedule 8 to the PSSVFO exempts certain SVFs from the licensing requirements. Such exemptions apply to loyalty and bonus point schemes with cash rewards or involving limited users' cash elements; SVFs used for purchasing certain digital products on online store platforms; and SVFs with limited usage (e.g., SVFs 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.

To be eligible for applying for an SVF licence, the SVF issuer must be a body corporate under Hong Kong law. This requirement will allow the HKMA to exercise effective supervision over the licensee even though some of its systems and operations may be located outside Hong Kong.

The minimum licensing criteria as stipulated in Schedule 3 to the PSSVFO are as follows:

(a) The principal business of the SVF issuer must be the issue of and/or facilitating the issue of SVFs;

(b) The SVF issuer must have a paid-up share capital of not less than HK$25 million;

(c) The officers and controllers of the SVF issuer must be "fit and proper" persons and possess adequate relevant knowledge and experience;

(d) The officers of the SVF issuer who are responsible for implementing the SVF scheme or the day-to-day management of the scheme must have the appropriate knowledge and experience to effectively discharge those responsibilities;

2 "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 the SVFs. The "float" of an SVF is outside the definition of "deposit" under the BO and the Deposit Protection Scheme Ordinance.

(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 that are commensurate with the scale and complexity of the scheme;

(f) There must be in place in the SVF scheme adequate and appropriate systems of control for preventing and combating possible money laundering or terrorist financing;

(g) The SVF issuer must have adequate risk management policies and procedures for the management of the float to ensure that there will always be sufficient funds for redemption of the stored value that remains on the facility, and ensure that at all times the float is kept separate from the SVF issuer's other funds and adequately protected by measures adopted by the SVF issuer;

(h) The SVF issuer must redeem in full the value stored in an SVF as soon as practicable upon receiving a redemption request from a user;

(i) The operating rules of the SVF scheme must be sound and prudent having regard to the purposes of the scheme and how the scheme is to be operated and governed; and

(j) The SVF scheme must be prudent and sound having regard to the purpose, business model and operational arrangement of the scheme, and must be operated prudently and with competence.

A one-year period starting from 13 November 2015 is allowed for existing SVF issuers or new market operators to apply for a licence from the HKMA. During this period, existing SVF issuers may 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 already been offering services to their users, this arrangement can avoid disrupting their normal operations and services to the public.

Supervisory Approach for SVFs

Compared to conventional banking business where banks play an important role in financial intermediation, SVFs are more about the provision of convenient retail payment services. While both banks and SVFs take money from their customers, the risks associated with banks and SVFs are fundamentally different, thereby calling for different supervisory approaches. This can be illustrated by drawing an analogy between banks and safety vaults on the one hand, and SVFs and wallets on the other hand (see diagram below). Specifically, banks accept deposits from the public and similar to safety vaults, banks are generally considered to be a secure way to store and accumulate personal wealth. Banking business entails risks including credit risk, interest rate risk, market risk, etc., and banking stability is of systemic importance. The focus of banking regulation is therefore more on the protection of deposits and preservation of public confidence in the banking system. SVFs, on the other hand, are similar to wallets loaded with cash for meeting daily retail payment needs in a convenient manner. The risks associated with SVFs are mainly operational risks and float safety; hence the regulatory focus of SVFs is to strike a reasonable balance between safety of SVF schemes and users' convenience in using SVFs for daily retail payments.

Supervisory Approach according to business nature and risks

	Banks	SVFs
	 	 
Business nature	▪ Deposit taking ▪ Lending and other banking services	▪ Provision of convenient retail payment services
Risks nature	▪ Credit risk, interest rate risk, etc.	▪ Operational risk ▪ Business risk
Regulatory focus	▪ Deposit protection ▪ Public confidence in the banking system	▪ Safe and efficient retail payment services ▪ Protection of float

With the SVF industry in Hong Kong still in its infancy, the HKMA has given due consideration to the need for striking a balance between user protection and market development in formulating the SVF supervisory policies. For instance, in setting the minimum capital requirement, operational sustainability of SVF licensees is balanced against potential barrier to market participation. In developing the float management policy, safety of float is weighed against operational flexibility of SVF licensees. On data privacy, the functions of SVF products are considered vis-a-vis protection of users' privacy. Similarly, user convenience has been taken into account in developing anti-money laundering (AML) and counter-terrorist financing (CTF) requirements applicable to SVFs. These aim to provide the necessary regulatory flexibility to cater for licensees with different scales of business and modes of operation amid the rapid technological development and innovations, while ensuring the interests of SVF users are protected.

Against this backdrop, the HKMA adopts a principle-and-risk-based approach in implementing SVF supervision under which SVF licensees are required to put in place appropriate risk management systems commensurate with their risk nature, business scale and complexity of the operation of their businesses. For example, on float management, SVF licensees are required to keep the float separate from their own funds and put in place effective arrangements to protect the float in case the issuer becomes insolvent. There should also be sufficient measures including internal controls to protect the float from other operational risks. On risk control and management, SVF licensees should have in place adequate security measures and internal controls to ensure the confidentiality and completeness of payment information, as well as the safety and effectiveness of their operating systems. Besides, SVF licensees are required to comply with the relevant requirements on protection of personal data and AML/CTF. Through an array of effective supervisory tools, the HKMA will assess the adequacy of individual SVF licensees' processes of risk identification and mitigation and whether they are operating in a safe and efficient manner and in compliance with the regulatory requirements and, where necessary, the HKMA will take appropriate follow-up actions.

Implementation Progress

Following the commencement of the PSSVFO in November 2015, more than 20 prospective applicants have approached the HKMA indicating interest in applying for SVF licences. Around one-third of the applicants are new market entrants and some are start-up companies. The HKMA issued two guidance documents, in November 2015 and January 2016 respectively, to provide guidance to prospective applicants on the SVF licensing regime as well as the key regulatory requirements. Dialogue has been held with prospective applicants through industry briefings, one-on-one meetings and daily communications to facilitate their licence applications.

The first batch of SVF licences was subsequently granted to five SVF issuers on 25 August 2016.[3] A list of current SVF licensees can be found in the "Register of Stored Value Facility Licensees" which is available on the HKMA's website for inspection by the public. It is expected that more SVF licences will be granted before the one-year transitional period ends.

In parallel with the licensing processing, the HKMA has issued the "Guideline on Supervision of Stored Value Facilities Licensees" ("Guideline") under section 54(1A)(b) of the PSSVFO to set out the high-level principles that the HKMA adopts in assessing whether certain requirements imposed on SVF licensees are complied with. To help SVF licensees better understand the standard by which the principles set out in the Guideline should be applied, the HKMA has issued Practice Notes to provide SVF licensees with additional guidance in respect of specific sections of the Guideline. Frequently Asked Questions will also be issued as and when necessary to give further explanations.

Meanwhile, the HKMA has launched a public education program to promote public awareness of the regulatory regime for SVFs. Two press briefings were held in April and August 2016 respectively to inform the media of the licensing progress. A series of promotional events including radio clips, web banners on popular social media, websites, apps and other relevant vehicles as well as TV advertisements have been rolled out or are being planned to enhance public understanding of the usage of SVFs and the protection afforded under the SVF regulatory regime.

Smart Tips on using SVFs

The implementation of the SVF regulatory regime will facilitate the introduction and adoption of new retail payment means while safeguarding the interests of users. That being the case, given that SVF industry in Hong Kong is still in its development stage, some SVF issuers may cease operation and exit the market due to competition or other commercial considerations. SVF users are therefore advised to exercise due care when choosing SVF services. Specifically, they should remember the following smart tips when using SVFs:

(i) Read and understand the terms and conditions of the SVF schemes, including fees, privacy policies, and user rights and liabilities.

(ii) Keep SVFs and passwords safe, and adjust security settings as necessary.

(iii) Avoid disclosing confidential information.

(iv) Check transaction records frequently in order to identify any unauthorised transactions in a timely manner.

(v) Manage stored value wisely and avoid loading too much money onto the SVFs.

[3] The first batch of SVF licensees are: Alipay Financial Services (HK) Limited; HKT Payment Limited; Money Data Limited; TNG (Asia) Limited; and Octopus Cards Limited.