BANKING ORDINANCE

Authorization of the issue of Multi-purpose Stored Value Cards

A Guideline issued by the Monetary Authority under section 16(10)

Introduction

1. This "Guideline on Authorization of the issue of Multi-purpose Stored Value Cards" (the Guideline), which is issued under section 16(10) of the Banking Ordinance (the Ordinance), describes the principles and criteria that the Monetary Authority (MA) will use in exercising his powers under the Ordinance for the authorization of Multi-purpose Stored Value Card (MPC) schemes.

2. In general, the purpose of the legislation is to provide that only authorized institutions which have been approved by the MA may issue MPCs. However, certain types of MPCs may be exempted from this requirement.

3. Because the market for, uses of and technology supporting stored value cards are still evolving, the MA considers it appropriate to set out relatively broad principles and criteria at this stage which will be further refined in the light of future developments. These principles and criteria will be applied to individual cases taking account of the special features of individual schemes.

The legal framework

4. In section 2 of the Ordinance, a "multi-purpose card" is defined as a card on which data may be stored in electronic, magnetic or optical form and for or in relation to which a person pays a sum of money to the issuer of the card (directly or indirectly) in exchange for:

   (a) the storage of the value of that money, in whole or in part on the card; and

   (b) an undertaking by the issuer (express or implied) that the issuer or a third party will, on production of the card, supply goods and services (which may include money).

5. A "single-purpose card" is one where the goods and services (which in this case shall not include money) are provided only by the issuer of the card (and not by a third party). The issue of single-purpose cards does not require approval under the Ordinance.

6. In addition to the issuer of a card, the Ordinance also introduces the concept of a "facilitator" who is defined in section 2(11) as a person who facilitates the issue of a MPC by the provision to the issuer of valuable consideration the value of which determines, whether in whole or in part, the extent to which the issuer may provide the undertaking referred to in (b) in paragraph 4 above. This definition would cover

any person who provides value to an issuer of a MPC which determines the extent to which the issuer can provide its customers with electronic value. An "originator" who creates electronic value and sells it to other banks for storage on cards issued by them would fall within this category (which is similar to a note-issuing bank that prints bank notes and sells these to other banks for distribution to their customers). However, a person who provides ancillary services which assist the issuer of a MPC, such as advertising, payment collection services, merchant acquiring or electronic data network facilities, will generally not be considered to be acting as a facilitator for the purposes of the Ordinance. Persons who are uncertain as to whether they may fall within the scope of the definition of facilitator are advised to consult the MA.

7. Under section 14A(1), no person shall issue or facilitate the issue of a MPC except an authorized institution which has been approved to do so under section 16(3A)(a).

8. Licensed banks are deemed to be approved to issue or facilitate the issue of MPCs. They need not therefore apply formally for approval though they would be expected to discuss in advance with the MA any plans to issue a MPC.

9. In addition, a special purpose vehicle whose principal business is or will be the issuing or facilitating the issue of MPCs may apply under section 15(3) for authorization as a deposit-taking company (DTC) in order to be approved to conduct that business. This provision means that non-banks may apply for approval through this route. The MA envisages that two main types of entity would apply:

   (a) service providers which wish to issue MPCs for the main purpose of charging for the services they provide; and

   (b) originators of electronic value who facilitate the issue of MPCs by other persons.

10. The MA has the power under section 16(9) to impose conditions on the issue of MPCs, including on the management of the money paid to the issuer of the card and whose value is stored on the card (the float). In addition, the MA can impose a requirement on an authorized institution to cease issuing or facilitating the issue of MPCs. Such conditions can be applied to all issuers/facilitators, including licensed banks.

11. Under section 2(14)(d), the MA may declare a stored value card, or a class of cards, not to be a "multi-purpose card" for the purposes of the Ordinance. This power may be used to exempt certain types of card from the approval requirements described above. Any exemption would however be subject to conditions set by the MA.

Principles and criteria for authorization

12. In applying the legal framework set out in the Ordinance, the MA will seek to achieve the following objectives:

(a) to maintain the stability of the payment system (and thus of the financial system as a whole); and

(b) subject to the above, not to stifle developments which would promote competition and innovation.

13. In keeping with the first objective, and bearing in mind that direct access to the payment system in Hong Kong is confined to licensed banks, it is intended that only licensed banks should have the ability to issue MPCs which are unrestricted in terms of the goods and services which they can be used to purchase. Such cards have "generally accepted purchasing power" and are thus a close approximation to money. In keeping with the second objective, however, it is intended that non-bank issuers should have the opportunity to apply for approval to issue MPCs which are more limited in scope.

The authorization of non-banks

14. The MA will normally adopt the following principles in considering applications for authorization and approval by non-bank issuers of MPCs:

(a) such cards should have a core use which is related to the business of the owners of the vehicle which issues the card;

(b) there may however be a number of ancillary or incidental usages which are intended to increase the convenience for card-holders. Such uses will be subject to the approval of the MA in advance. The card may not be used for other purposes without the consent of the MA;

(c) the card issuer will be expected to justify, and present an acceptable business case for, the ancillary or incidental uses of the card; and

(d) the ancillary or incidental uses should not overwhelm the core use. The issuer would be required to demonstrate that the other uses would not exceed the core use in terms of the aggregate value of transactions.

15. In the case of non-banks, the actual entity to be authorized to issue or facilitate the issue of MPCs would have to be a special purpose vehicle whose principal business is the issue of MPCs (or facilitating such issue). This is necessary to provide an identifiable balance sheet to which the capital adequacy and other provisions of the Ordinance can be applied. It will also help to segregate the assets backing the issue of the cards and reduce the possibility that other creditors will have a claim on such assets.

16. A special purpose vehicle applying to be authorized as a DTC will be required to meet the authorization criteria set out in the Seventh Schedule to the Ordinance. These would include adequate financial resources, fitness and properness of management and controllers, adequate systems of controls, etc. Applicants should therefore study the Guideline on Minimum Criteria for Authorization issued by the MA.

17. The normal supervisory and statutory provisions which apply to DTCs will apply to such special purpose vehicles except that money which is paid to an issuer in return for storing its value on a MPC will not be subject to the restriction on the minimum size and maturity of deposits which apply to DTCs. It will be a condition of authorization that the vehicle will not engage in other types of deposit-taking or lending business (although some purely incidental taking of deposits may be allowed). The normal criterion that a DTC should be at least 50% owned by a bank will not apply.

18. In considering applications for authorization, the MA will also have regard to the following areas relating to the MPC scheme:

    (a) the soundness of the scheme;

    (b) the arrangements for management of the float; and

    (c) the business plan.

<u>The soundness of the scheme</u>

19. In determining whether a scheme is sound, the MA would need to be satisfied about features such as the following:

    (a) the purpose of the scheme, including the range of uses of the cards;

    (b) the security features, including the design of the microchip and the encryption technology, any limit on the amount that can be stored on the card and limits on transaction value;

    (c) the risk management and internal control procedures, including those relating to the creation and transfer of value, the issuance of cards and the detection of fraud;

    (d) contingency plans to deal with disaster recovery and compromise of the scheme, e.g. as a result of fraud;

    (e) the terms and conditions of the scheme, including the rights, obligations and liabilities of the various parties involved (for example arising from lost or stolen cards or from counterfeit value);

    (f) the clearing and settlement arrangements; and

    (g) the audit trail for transactions made with the card.

<u>The arrangements for management of the float</u>

20. An applicant must satisfy the MA that it has adequate risk management policies and procedures for the management of the float to ensure that there will be sufficient funds for the redemption of outstanding stored value. In general, the MA will wish to be satisfied that the float will be managed in a professional manner and

that applicants have the requisite competence and expertise in this area.

21. Applicants will be required to discuss with the MA their policies for float management. Such policies should clearly describe how the liquidity requirements for the scheme are determined and how the float will be managed and invested to meet such requirements. The MA will need to be satisfied that the types of investment which the issuer proposes to make are appropriate having regard to the nature and liquidity needs of the scheme. The various types of risk to which the float is exposed (e.g. credit, liquidity, market risk) should be clearly identified along with the policies and procedures for managing these risks.

The business plan

22. Prospective issuers should discuss their business plans with the MA in advance. In reviewing the business plan of prospective issuers, the MA will need to be satisfied that the scheme will be operated prudently and with competence, and in a manner which will give users a measure of protection and will not affect the stability of the payment system.

23. The business plan of prospective issuers should normally cover a 3-year time horizon. It should include statistical information about the expected number of cards to be issued, the average value expected to be stored on the cards, the value of the float, the proposed range of uses of the card and the expected annual value of transactions split between core and non-core uses.

24. Although licensed banks are not required to seek the approval of the MA to issue MPCs, those which intend to do so should discuss their plans with the MA in advance. This is to enable the MA to evaluate whether the proposed MPC scheme is sound and will be managed prudently. In doing so, the MA will have regard to the matters set out in paragraphs 18 to 23 above.

Principles and criteria for exemption

25. Non-bank entities which wish to issue MPCs will normally follow the authorization and approval route described above. However, the legislation provides for the MA to grant exemption from the approval process to certain types of MPC. In general, it is envisaged that exemption would be granted only where the risk to the payment system and to cardholders from a particular card is considered to be slight and where it is considered unnecessary to require the issuer to be authorized. In this connection, consideration would be given to the extent to which the card in question fell technically within the definition of “multi-purpose card” but simply replaced an existing non-regulated payment instrument such as travelers’ cheques.

26. In considering applications for exemption, the MA will apply the following principles:

    (a) applicants should:

        (i) possess substantial financial strength (either in their own right or as a

result of parental support);

(ii) be in reputable ownership; and

(iii) be able to demonstrate technical competence to be able to operate a card scheme in a safe and sound manner.

(b) there should be a limit to the risk of cardholders, for example by limiting the maximum amount that can be stored on each card; and

(c) the card should only be capable of being used within a distinct and limited geographical area, such as a university campus, and the number of cards that will be issued is thus relatively small; or

(d) there is a more limited range of ancillary and incidental uses than with "authorized" cards and a more direct connection between those uses and the core use of the card.

27. For the purposes of principle (b), the maximum amount that can be stored on an exempt card should normally be $1,000 or less. For the purposes of criterion (d), the related ancillary and incidental uses are not expected to exceed 15% of the aggregate value of transactions. These amounts will be subject to variation from time to time.

28. In considering applications for exemption, the MA will require information similar to that described in paragraphs 18 to 23 above. The MA will also require issuers to submit information relating to their financial strength and ownership structure. Any exemption granted by the MA may be subject to conditions. The MA will exercise this power to require issuers of exempt cards to provide it with statistical information on a regular basis, including details of the number of cards issued, the aggregate amount of stored value, the average amount of stored value per card, the number of transactions, and the value of transactions split between core and non-core uses. Issuers may also be required to include a warning in the application form or in other materials relating to an exempt card, in a manner acceptable to the MA, that the issuer is not subject to the on-going supervision of the MA. The MA will reserve the right to withdraw an exemption or to vary the conditions attaching to it. Normally, the MA will only withdraw an exemption if the issuer no longer meets any of the criteria for granting an exemption as set out in paragraphs 25 to 27 or breaches any of the conditions attached to the exemption.