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LegCo Panel on Financial Affairs
Special Meeting on 19 January 2005

Administration's written response to issues raised by Members

Item 1 on the List of Follow up actions

The Member's comments were conveyed to the Financial Secretary.

Item 2: Issues raised by Hon SIN Chung-kai

A1: With the concerted efforts of the Government, the regulatory bodies and the industry, we have made considerable progress in the past year in enhancing the regulatory regime, raising corporate governance standards, improving financial infrastructure, strengthening protection for shareholders and deposit holders as well as promoting the development of the bond market. The progress we have made in this respect is also recognized by international organizations. The recent International Monetary Fund Staff Mission to Hong Kong also noted the substantial progress we made in the enhancement of regulatory and supervisory arrangements, improved transparency of institutional and policy framework and further advances in corporate governance.

In fact, under the joint efforts made by the Government and concerned parties, our financial services industry has made promising performance in the past year. The amount of funds raised by our stock market last year ranked the third in the world, ahead of London and Tokyo, reaching HK$270 billion which is five times the amount of ten years ago. Up to the end of December 2004, the total market capitalization of our stock market was HK$6,695.9 billion, representing 85% increase over the end of 2002. The average daily turnover in 2004 was HK$15.97 billion, rising by 140% over 2002.

We will continue to make our best efforts and implement appropriate measures, having regard to market development needs, to enhance our strengths and expand our financial services industry.

A2. 2.1 The Government will strive to restore fiscal balance and bring public expenditure down to 20% of the Gross Domestic Product (GDP) or below by 2008-09 through boosting the economy, raising revenue and cutting expenditure. We will, from time to time, review the relevant economic forecasts, actual expenditure requirements and revenue estimates, and formulate policies on public finances in light of the actual situation as far as practicable.

To boost the economy, the Chief Executive has set in his 2005 Policy Address the direction for future development, which includes consolidating the four core industries, implementing the Closer Economic Partnership Arrangement (CEPA), promoting regional co-operation, etc. In fact, over the past year, the economy of Hong Kong has witnessed a broad-based upturn. The forecast growth rate in real terms of GDP for 2004 has been revised upwards from 6%, as announced in the Budget in March last year, to 7.5%. Moreover, deflation, which had persisted for 68 months, finally ended in July last year.

To contain expenditure, the Financial Secretary has, in the 2004-05 Budget, laid down expenditure guidelines for the ensuing years, including reducing operating expenditure to $200 billion by 2008-09. As for capital expenditure, we will continue to follow the principle of “spending where necessary” and invest in infrastructure projects to enhance the attraction of Hong Kong as an international trade, transportation and communications hub to meet our future development needs. The Government will set expenditure ceilings every year, taking into account the actual requirements of different policy bureaux.

According to the medium range forecast in the 2004-05 Budget, we will achieve the target of bringing public expenditure down to below 20% of the GDP by 2006-07. The Financial Secretary will give an account of the latest medium range forecasts in his 2005-06 Budget to be delivered on 16 March 2005.

A2 2.2 To reduce the Government's operating expenditure to $200 billion, each department needs to do its part. The rate of reduction will vary according to the circumstances of individual departments and the Government's overall policy agenda. We will assess the priorities of the needs of various sectors of the community and set the expenditure ceilings accordingly. To ensure more effective use of public resources, directors of bureaux will prioritise the allocation of resources in light of policies implementation, and will conduct functional reviews of departments under their purview, including re-prioritisation of services provision, streamlining organisational structures and re-engineering procedures, etc. Each year when we prepare the Budget for the next financial year, we will review the situation and work out the estimated expenditure. We will consider making adjustments, having regard to such factors as services quality, community needs, price fluctuations and economic development, but the financial position of the Government remains our basic consideration. Members' views on the subject are most welcome. As regards civil service pay adjustment, it operates through an established mechanism and will not affect the Government's determination to achieve the target of eliminating the fiscal deficit by 2008-09.

A3. <u>Promoting the bond market development</u>

The Government has put in a lot of efforts to promote the bond market in recent years, including providing the necessary financial infrastructure, simplifying the issuance process, offering tax incentives and encouraging public corporations to issue bonds.

Last year, the Government successfully launched a HK$6 billion toll road and bridge securitisation bond programme and a HK$20 billion Global Bond Offering. The overwhelming response from retail investors to the two Government bond programmes has indicated that the awareness level and interest of the public in bonds has been raised substantially. The programmes have also increased the public's investment choices. The successful launch of these programmes has also proved that Hong Kong possesses the expertise and infrastructure for large scale bond issuance. This will help attract local and foreign institutions to issue bonds in Hong Kong.

The Government will continue to promote the development of the bond market from different fronts, including reducing regulatory impediments. In this respect, the Government is reviewing the existing regime of offer of shares and debentures to the public in three phases:

- 1st Phase: The Securities and Futures Commission (SFC) issued in February 2003 various guidelines permitting awareness advertisements, a "dual prospectus" structure, and allowing faxed copies of expert consent letters and bulk print proofs of prospectuses for the purposes of registration. The SFC also issued two class exemptions relating to prospectuses for offers of debentures.

- 2nd Phase: The prospectus-related provisions of the Companies (Amendment) Ordinance 2004 commenced in December 2004. Major improvement measures contained in the Ordinance include exempting 12 types of offers from the prospectus regime such as offers to "professional investors" and offers to not more than 50 persons.

- 3rd Phase: The SFC is conducting the 3rd Phase comprehensive review of the regulation of public offers of securities. It aims to put forward proposals for public consultation in the first quarter of 2005.

Separately, the Mandatory Provident Fund Schemes Authority has been reviewing the related MPF legislation and guidelines to facilitate investment in bond market under the MPF schemes.

The approval given by the Mainland authorities last year allowing the investment of a portion of the foreign currency funds of the Mainland insurance companies and also the National Social Security Fund in overseas markets are also significant developments. We believe that Hong Kong's bond market would likely benefit from these liberalization measures as the majority of these Mainland funds will be pursuing stable returns. To take advantage of these developments, the Government has been in touch with the various Mainland authorities to promote the Hong Kong financial market.

Hong Kong will also continue to join forces with other Asian economies to promote the development of local and regional bond markets. For example, Hong Kong has been actively participating in the promotion of the launch of Asian Bond Fund by EMEAP to promote the development of bond index fund in the region and to strengthen the local and regional bond market infrastructures.

Moreover, the Government has been strengthening education on bond investment and will continue the efforts with the industry on investor education to raise the awareness and interest of the public in bond investment.

<u>Promoting fund management industry</u>

The remarkable economic growth in the Mainland provides great opportunities for the further development of Hong Kong's financial market. One of the major new policy initiatives this year is to further promote Hong Kong's asset management industry by capitalising on the growing opportunities in the

Mainland. We will continue with our efforts in providing a conducive environment for development in this area, including completing as soon as possible the legislative work for giving effect to the exemption of offshore funds from profits tax and the review on estate duty.

Besides, a major initiative undertaken by SFC this year is to facilitate the processing of UCITS III funds. The SFC recognizes the potential implications on the fund management industry in Hong Kong as a result of the implementation of the new Undertakings for Collective Investment in Transferable Securities (UCITS) III directives[1] in Europe. The SFC has informed market practitioners and the public that the SFC will process UCITS III fund applications. In fact, the SFC has already started doing so. In reviewing such applications, the SFC expects the fund documents to contain clear and plain-language disclosures on the changes under UCITS III, the resultant risks and the risk management measures put in place. An investor education programme will also be conducted to inform investors of the new investment flexibility offered under UCITS III funds. The SFC believes that the Hong Kong public will continue to have access to a wide range of investment products as a result of the transition to the UCITS III regime. In the longer term, the SFC will review the Code on Unit Trusts and Mutual Funds (the "Code") and consult the market as to how the relevant features of UCITS III could be accommodated in the Code.

The SFC will also conduct a review on the "Guidelines on Hedge Funds" and the "Guidelines on Hedge Funds Reporting Requirements", based on the experience that it has accumulated over the last two years in the authorization of hedge funds. The

[1] UCITS III directives comprise a new EU Product Directive and a new Management Directive, and was adopted at the end of 2001 (effective in February 2002). It updates the UCITS I directive with a view to enhancing a "European fund passport system". Key changes under UCITS III include the expansion of the investment powers of funds and the use of financial derivatives for investment purposes, in addition to hedging or efficient portfolio management as previously allowed under UCITS I.

review aims to further enhance the transparency of hedge funds and to promote investor education.

Item 3 on the List of Follow up Actions

- Under the existing MPF legislation, the trustees of registered schemes are allowed to invest in real estate investment trusts, but it does not provide for the acquisition of units in the Link REIT through an offer to the public at the pre-listing stage. Nevertheless, the MPF schemes could acquire the units through international offering.

- We understand that the MPF Schemes Operation Review Committee ("SORC") set up by the Mandatory Provident Fund Schemes Authority ("MPFA") has been considering relevant legislative proposals in late 2004. The SORC will continue to review the MPF legislation and guidelines constantly in order to enhance the efficiency of the MPF regime and ensure that the MPF Schemes could capitalise on new investment opportunities. Upon receipt of specific recommendations from the MPFA to amend the MPF legislation, the Administration will consider such proposals carefully, and see how these legislative proposals should be taken forward.

Item 4 on the List of Follow up Actions

To ensure that the average wage rates (which relate to an average number of normal hours of work per day and average number of standard working days per month) offered to non-skilled workers by service contractors will not be lower than those in the relevant industry or occupation in the market, the Government has introduced mandatory requirements for tender assessments and evaluation of wage offers on 27 March 2004 and 6 May 2004 respectively for service contracts (excluding construction services) that rely heavily on non-skilled workers. Procuring departments must follow these mandatory requirements in the tendering of the relevant service contracts.

In implementing the mandatory wage requirement, the Government has adopted the average monthly wage rates published in the Census and Statistics Department’s Quarterly Report of Wages and Payroll Statistics (the Quarterly Report) as the basis of the mandatory wages. This is because the information in the Quarterly Report best reflects the market wage rates of the relevant industry or occupation. The calculation of the wage rates is based on net hours of work, which exclude meal and rest breaks. A tender offer will not be considered if the average monthly wage rates offered by the tenderer to the non-skilled workers for carrying out the contract are less than those in the relevant industry or occupation in the market as published in the latest Quarterly Report at the time when tenders are invited. Tenderers are also required to specify in the tender offer the proposed allowable daily maximum working hours which are binding after award of tender. Conditions of employment, including wage rates and working hours specified in the contract are binding on the contractors.

To enhance the protection of non-skilled workers of outsourced service contracts, procuring departments have included appropriate employment-terms related provisions in respect of wages, working hours and signed written employment contracts with employees (except temporary leave relief worker with employment period not longer than seven days) in the tender documents for outsourced service contracts. Procuring departments have also devised their monitoring mechanism to ensure their service contractors comply with the contractual obligations in respect of wages, working hours and signed written employment contracts with their non-skilled workers, and where appropriate, will apply provisions in the contract to punish those service contractors who breach the contract provisions. The Labour Department will also step up enforcement of the Employment Ordinance and Employees’ Compensation Ordinance.

The Labour Department has drawn up a draft standard employment contract setting out clearly the wage rate, working hours, and other employment conditions for use in outsourced service contracts in order to minimise the opportunity of government service contractors paying their non-skilled workers monthly wages less than that committed in the tender offer. Moreover, procuring departments are revising their marking scheme for assessment of tenders for service contracts to include a criterion to evaluate the proposed wage rates offered by tenderers to non-skilled workers. Tenderers who are willing to offer wage rates higher than those for the relevant industries/occupations as published in the Quarterly Report will be awarded higher marks.

The LegCo Panel on Manpower has discussed the issue on the employment terms for non-skilled workers engaged in services contracted out by the Government. The above information has been submitted to the Panel. We will continue to follow up the issue with the Manpower Panel if necessary.

Item 5 on the List of Follow -up Actions

- It is understood that CITB and the Government Economist are conducting an analysis of the economic impact of CEPA on Hong Kong (including the impact on local employment). The study will cover three aspects : trade in goods, trade in services, and Individual Visit Scheme. It is expected that the study on trade in services under CEPA I will be completed in the first quarter of this year. CITB will report the results on trade in services to the LegCo Panel on Commerce and Industry in April, and will publish them.

- We believe that CEPA will have positive impact on the financial services sector. With the implementation of CEPA, enormous opportunities are being opened up for the financial services sector in Hong Kong, and economic co-operation and integration between Hong Kong and the Mainland are also being greatly enhanced. Apart from bringing benefits to the financial services sector in its expansion into the Mainland market and the opening up of new business opportunities, the implementation of CEPA will also boost Hong Kong’s attractiveness to overseas investors and, directly and indirectly, create job opportunities.