

**Information Note for
LegCo Panel on Financial Affairs**

**Policy Initiatives of
the Financial Services and the Treasury Bureau**

Introduction

The 2005-06 Policy Agenda of the Government of the Hong Kong Special Administrative Region (“the Government”) has been issued on 12 October 2005. This information note elaborates on the new and on-going policy initiatives that relate to the Financial Services and the Treasury Bureau.

Financial Services

Overview

2. The financial services sector, encompassing key services such as banking, securities, insurance, fund management and other related services, is one of the key pillars of the Hong Kong economy. With various policy initiatives and improvement measures implemented in recent years, we have maintained and further strengthened Hong Kong’s position as a major international financial centre (“IFC”).

3. We now run the 9th largest stock market in the world and 2nd in Asia in terms of market capitalization, the world’s 15th and Asia’s 3rd largest international banking centre in terms of external banking transactions and the 6th largest foreign exchange market in terms of turnover. In terms of equity raised in 2004, Hong Kong ranked 4th, ahead of London and Tokyo. As for insurance, total gross premiums reached HK\$122 billion in 2004, and with about 180 authorised insurers, we have the highest concentration of insurers in Asia. The total net asset

value of Mandatory Provident Fund (“MPF”) schemes reached HK\$139 billion, with around 98% of relevant employers and 97% of relevant employees being enrolled in MPF schemes.

4. As at end September 2005, 29% of enterprises listed in Hong Kong are from the Mainland. These 318 listed enterprises amount to roughly 34% of our market capitalisation and 45% of our market turnover. The vast majority of Mainland enterprises listed outside the Mainland are quoted on our stock exchange. Of those listed in Hong Kong, only a minority are also listed in other overseas markets, and more than 70% of their trading is conducted in Hong Kong. Hong Kong has already become the Mainland’s premier capital formation centre.

2005-06 Policy Agenda

5. Looking into the coming year, we will continue to devote efforts to enhance Hong Kong’s position as a major IFC and the premier capital formation centre for the Mainland. These initiatives are aimed at promoting market development and improving market quality.

Promoting Market Development

Pan-PRD Co-operation

6. We will continue to seize the opportunities brought by the development of the Mainland economy. The opportunities which the Mainland’s growth presents for our financial markets are enormous. In particular, we will strengthen our co-operation with the Pan-Pearl River Delta (“Pan-PRD”) on financial services.

7. Pan-PRD regional co-operation will broaden Hong Kong’s market access to more ventures in project financing, capital-raising through listing and investment consultation, thereby enhancing the development of our financial market. At the same time, Hong Kong can make further contributions towards the reforms and modernization of the Pan-PRD region by providing an international fund-raising and investment platform.

8. We will continue to strive to identify new room for Pan-RRD regional co-operation. In end-September 2005, the Secretary for Financial Services and the Treasury led a delegation of more than 70 representatives from Hong Kong's financial services sector to visit Fujian Province. Comprising leading figures of the banking sector, venture capital investment funds, chambers of commerce, securities industry, and accounting and legal professions, it was the first financial services delegation under the Pan-PRD Regional Co-operation Framework. The visit has enabled Hong Kong's financial services sector and entrepreneurs to have a better idea of the latest development and investment opportunities in Fujian, and to showcase Hong Kong's strengths as an IFC with an aim to enhance economic co-operation between the two places.

9. Looking ahead, we will host a Financial Services Forum in March next year to highlight Hong Kong's role as the prime capital formation and global investment platform for the Mainland. The Forum will serve to enhance the understanding of leaders from the Pan-PRD provincial/regional governments, as well as representatives from enterprises in the region on various financial services, in particular fund-raising and investment services, provided by Hong Kong.

10. We will continue to leverage on the opportunities arising from the Pan-PRD regional co-operation, as well as the preferential access given to the financial services sector under the Mainland and Hong Kong Closer Economic Partnership Arrangement ("CEPA") to enable our financial services providers to gain quicker access to the Pan-PRD region and better promote the regional economy.

11. We welcome the Central Authorities' in-principle agreement to expand the renminbi (RMB) business in Hong Kong, which includes raising the limit for exchange between RMB and Hong Kong Dollars made in cash and the RMB remittance limit; lifting the credit limit of RMB cards issued by banks in Hong Kong; expanding the definition of designated merchants to cover more sectors; and permitting the designated merchants to open RMB cash deposits accounts and exchange the RMB deposits one-way into Hong Kong Dollars. In addition, Hong Kong residents would be allowed to issue RMB cheques for a limited

amount for consumer spending within Guangdong Province. We understand that the People's Bank of China and the relevant authorities will soon finalize the detailed arrangements of the newly expanded areas. These measures will further promote economic integration between Mainland China and Hong Kong and facilitate cross-border spending, and improve the mechanism for channelling RMB in Hong Kong back to the Mainland. The new measures will strengthen Hong Kong's status as an international financial centre.

Asset Management

12. The prospects for asset management business are tremendous. Hong Kong's total asset management business in 2004 amounted to HK\$ 3,618 billion, up 23% from 2003. We are committed to providing a conducive environment for the further development of the asset management industry. To this end, the Government has proposed to abolish estate duty and exempt offshore funds from profits tax. In May 2005, we introduced a bill to abolish estate duty with a view to encouraging the holding of assets in Hong Kong. In July 2005, we introduced another bill into the Legislative Council ("LegCo") which provides for profits tax exemption for offshore funds.

13. These measures will help strengthen our competitiveness as an IFC and attract international investors to invest in our financial markets and make use of the services provided by our financial institutions, in particular the asset management industry. These measures will also encourage more and more global fund houses and professionals to come to Hong Kong.

14. Another key factor supporting the further development of Hong Kong's asset management business is the rapid economic growth in the Mainland, which has greatly expanded personal savings and thereby increasing the demand for investment products. Given our proximity, linguistic and cultural affinities, knowledge of and close relationship with the Mainland, Hong Kong is best placed to serve as the preferred asset management centre for the Mainland in the long run. We will continue to explore how we can assist the industry in capitalising on the opportunities.

Bond Market Development

15. We are committed to increasing the breadth and depth of our bond market. To this end, we are continuing our multi-pronged approach to promote our bond market. Measures taken so far, such as streamlining of procedures for bond issuances, providing tax incentives and enhancing the infrastructure, have contributed to the encouraging progress over the past year. It is also worth noting that Hong Kong is actively involved in regional bond market development initiatives (for example, the Asian Bond Fund 2), which are conducive to the development of the local market. We will continue our efforts to encourage more local and international issuers to use our bond issuance platform.

16. The Securities and Futures Commission (“SFC”) is consulting the public on possible reforms to modernize the regime governing the public offering of shares and debentures, with a view to encouraging capital raising and issuance of securities in Hong Kong.

Improving Market Quality

Regulatory Reform

17. To further Hong Kong’s development as a major IFC, we are continuing our efforts to review and improve the regulatory regime of our financial services sector in light of the actual experience, market development and international trends. A robust regulatory regime is the key to maintaining a quality market and we are always mindful of the need to ensure that our standards are on a par with those of other major international financial centres.

18. On banking, implementation of the new capital adequacy standards for banks, commonly known as “Basel II”, is important to enhance the banking sector’s risk management capability and stability. Our effort in this regard has received general support from the industry and the legislature, as evidenced by the enactment of the Banking (Amendment) Ordinance 2005 in July 2005. The Hong Kong Monetary

Authority is now proceeding with the development of capital rules and disclosure rules which will set out the detailed standards and requirements, with an aim to table the rules in the LegCo by mid-2006.

19. For the securities market, we completed in March 2005 the public consultation on proposed amendments to the Securities and Futures Ordinance to give statutory backing to major listing requirements. We are refining the proposed legislative amendments in light of comments received. We aim to introduce a Securities and Futures (Amendment) Bill into the LegCo in the 2005/06 legislative session.

20. On the other hand, the SFC has conducted a public consultation on the regulatory regime specific for sponsors, and is in the process of reviewing market responses. The SFC will continue its dialogue with the industry with a view to improving the regulation of sponsors.

21. Another key initiative to improve CG is to enhance the oversight of auditors and quality of financial reporting through the proposed establishment of the Financial Reporting Council (“FRC”). The FRC will be tasked to investigate irregularities of auditors in relation to listed entities and enquire into the non-compliances of the financial reports of these entities with the relevant legal, accounting and regulatory requirements. For this purpose, a Bill has been introduced into the LegCo.

22. As regards the insurance sector, we have reviewed the institutional set up of the Insurance Authority and have consulted the LegCo and the industry on the proposal to enhance the independence of the regulator. We are looking into the staff redeployment, financial arrangement and other related issues, and aim to develop a detailed proposal together with a timetable for implementation in the next few months for further consultation with stakeholders.

23. We plan to commence a rewrite exercise in respect of the Companies Ordinance in mid-2006. The objective is to provide Hong Kong with a legal infrastructure which meets its needs as a major international business and financial centre.

Corporate Governance

24. We will continue to devote efforts to promote corporate governance (“CG”) of our financial markets. To this end, we together with other relevant parties, including the regulators and professional bodies, will continue with our efforts in upgrading Hong Kong’s standard under a “3C” approach, namely “*Compliance*” (for example, introduction of legislation to give statutory backing to major listing requirements as mentioned in paragraph 19 above), “*Culture*” (for example, investor and public education to promote a CG culture) and “*Collaboration*” (for example, co-ordination between the regulators in enforcing the relevant laws and rules).

Investor Protection

25. Closely linked to market quality is investor protection, which is essential to the stability of our financial markets. To this end, we will continue our work to roll out the Deposit Protection Scheme. The Hong Kong Deposit Protection Board, formed in July 2004, is progressing on a number of key tasks to prepare for the launch of the Deposit Protection Scheme. One of these is the preparation of a set of rules governing the operation of the Scheme. It is expected that the Scheme will start providing deposit protection in the second half of 2006.

26. We are also working with the Mandatory Provident Fund Schemes Authority to review and improve different aspects of MPF schemes including investment regulation, scheme administration, member protection and enforcement. In particular, we aim to introduce the Mandatory Provident Fund Schemes (General) (Amendment) Regulation 2005 into the LegCo in the 2005/06 legislative session. The objective of this legislative exercise is to improve the existing investment regulation for the better protection of the MPF scheme members in respect of their investment in the MPF scheme funds.

FISCAL POLICY

Fiscal Targets

27. In the October 2005 Policy Agenda, we pledge to continue the strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of GDP, in line with the principle of keeping expenditure within the limits of revenue. We will also review our tax base and continue to implement the asset sale and securitization programme.

28. With the steady economic upturn, the fiscal position for 2004-05 has improved. The Consolidated Account recorded a surplus of \$21.4 billion for the year. After discounting the proceeds from bond issuances, there was a small deficit of \$4 billion. However, we still forecast a deficit in the Operating and Consolidated Accounts in the coming year or so, and would need to continue our efforts to restore fiscal balance.

29. In 2005, we have continued to identify suitable assets for sale or securitization in accordance with the principle of “Big Market, Small Government”. We have decided to downsize our shareholdings in Tradelink Electronic Commerce Limited through participation in its Initial Public Offering. We are also making progress in drawing up a plan to sell part of our student loan portfolio to financial institutions.

**Financial Services and the Treasury Bureau
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