

立法會
Legislative Council

LC Paper No. CB(1)2744/09-10

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by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of meeting
held on Monday, 5 July 2010 at 10:45 am
in the Chamber of the Legislative Council Building

Members present : Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon Ronny TONG Ka-wah, SC (Deputy Chairman)
Hon Albert HO Chun-yan
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Dr Hon David LI Kwok-po, GBM, GBS, JP
Hon James TO Kun-sun
Dr Hon Philip WONG Yu-hong, GBS
Hon Abraham SHEK Lai-him, SBS, JP
Hon Vincent FANG kang, SBS, JP
Hon Jeffrey LAM Kin-fung, SBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon WONG Ting-kwong, BBS, JP
Hon CHIM Pui-chung
Hon KAM Nai-wai, MH
Hon Starry LEE Wai-king, JP
Dr Hon LAM Tai-fai, BBS, JP
Hon Paul CHAN Mo-po, MH, JP
Hon CHAN Kin-por, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP

Member absent : Hon Emily LAU Wai-hing, JP

Public officers attending : Agenda Item II
Miss Natalie LI
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services) 5

Mr WONG Kuen-fai
Deputy Commissioner of Inland Revenue (Technical)

Mr Daryl HO
Head (Market Development)
Hong Kong Monetary Authority

Agenda Item III

Ms Shirley KWAN
Principal Assistant Secretary for Financial Services and
the Treasury (Treasury)

Mrs Teresa CHU, JP
Deputy Commissioner (Operations)
Inland Revenue Department

Mr CHIU Sai-ming
Chief Assessor (Computer)
Inland Revenue Department

Mr LEUNG Kam-hang
Chief Systems Manager (Inland Revenue)
Inland Revenue Department

Clerk in attendance: Ms Anita SIT
Chief Council Secretary (1)5

Staff in attendance : Mr KAU Kin-wah
Assistant Legal Adviser 6

Mr Noel SUNG
Senior Council Secretary (1)4

Ms Haley CHEUNG
Legislative Assistant (1)8

I Information papers issued since the last meeting

(LC Paper No. CB(1)2171/09-10 — Securities and Futures Commission's press release and extracts on "Consultation conclusions on proposals to enhance protection for the investing public"

LC Paper No. CB(1)2272/09-10 — Hong Kong Mortgage Corporation Limited 2009 Annual Report)

Members noted the information papers issued since the last regular meeting on 7 June 2010.

II Legislative proposal to enhance the qualifying debt instrument scheme

(LC Paper No. CB(1)2364/09-10(01) — Administration's paper on "Legislative proposal to enhance the qualifying debt instrument scheme")

Briefing by the Administration

2. The Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)5 (PAS(FS)5) briefed members on the legislative proposal to amend the Inland Revenue Ordinance (IRO) (Cap. 112) for enhancing the qualifying debt instrument (QDI) scheme, by highlighting the salient points in the paper.

Financial and economic implications of the proposal

3. While supporting the initiative to enhance the QDI scheme, Mrs Regina IP questioned why the initiative was not taken earlier, and whether the legislative proposal would be adequate to develop Hong Kong's debt market. Mrs IP and Mr CHAN Kin-por enquired about the estimated increase in QDI issuance in Hong Kong and the estimated amount of profits tax forgone, and how the Government could assess the effectiveness of the enhanced QDI scheme. The Deputy Chairman enquired about the economic benefits that would be generated for Hong Kong as a result of the proposed enhancements to the QDI scheme, e.g. whether stamp duty was imposed on debt instrument transactions and the estimated increase in revenue from stamp duty arising from the enhanced QDI scheme.

4. PAS(FS)5 responded that the QDI scheme was first introduced in the mid-1990s, and was refined in 1999 and 2003. The present legislative proposal for enhancing the QDI scheme aimed to further develop the local debt market. The Government would keep the implementation of the present proposal, which was

subject to the approval of the Legislative Council in due course, under constant review. The estimated amount of revenue forgone from the enhanced tax concession was about \$158 million per annum. This notwithstanding, the proposal would help to further develop the local debt market, thereby benefiting Hong Kong's economy. Such benefits could not be quantified though. As regards stamp duty, the existing arrangement applicable to debt instruments would continue (i.e. no stamp duty would be charged).

5. The Head (Market Development), Hong Kong Monetary Authority (H(MD)/HKMA) said that in drawing up the legislative proposal, the Government had consulted the relevant financial institutions which issued debt instruments in Hong Kong and other economies in the region, and had made reference to similar policies of other jurisdictions in the region. The proposed enhancements were considered appropriate for striking a balance between meeting market development needs and minimizing the risk of tax avoidance. An active and well-functioning debt market would increase the efficiency of raising capital required to sustain economic growth and help stabilize the financial system during a regional/global financial crisis. The relevant financial services sectors such as banks, legal practitioners and accountants would also benefit from the development of the debt market.

6. In response to Mrs Regina IP's enquiry as to why Hong Kong's corporate bond market was dominated by privately-placed short-term debt instruments with an original maturity of less than three years, H(MD)/HKMA remarked that in smaller debt markets like those in Australia, Singapore and Hong Kong, issuers would issue debt instruments to meet the specific needs of particular groups of investors. Under the practice of reverse enquiry, an investor or a small group of investors might initiate an arrangement with an issuer under which the issuer would issue a particular debt instrument to the investor/ group of investors only.

7. At the request of Mrs Regina IP, the Administration agreed to provide details of the types of debt instruments available in the Hong Kong market, including their original maturity, their issuers and their percentages out of the total issuance in the market, and an analysis of the development of the debt market in Hong Kong.

(Post-meeting note: The information provided by the Administration was circulated to members vide LC Paper No. CB(1)2664/09-10 on 28 July 2010.)

Coverage of the QDI scheme

8. Mrs Regina IP asked whether the enhanced QDI scheme would cover debt instruments denominated in foreign currencies, derivatives, Exchange Fund bills and notes and "zero coupon" bonds. She also asked why the proposed enhancement did not include long-dated bonds.

9. PAS(FS)5 responded that under section 14A of IRO, the QDI scheme covered debt instruments which had a minimum denomination of HK\$50,000 or its equivalent in a foreign currency. Therefore, QDIs in foreign currencies were already

covered by the scheme. In addition, pursuant to section 26A of the IRO, a 100% exemption from profits tax was granted for interest income and trading profits arising from QDIs with an original maturity of not less than seven years. H(MD)/HKMA advised that "zero coupon" bonds which met the criteria of the QDI scheme would be granted tax concession under the scheme. On the other hand, structured financial products were not classified as QDIs and therefore were not granted tax concession under the QDI scheme. In addition, under section 26A of IRO, the Exchange Fund bills and notes were already tax exempted.

10. Mr James TO enquired about the legal backing for the QDI scheme, and asked whether it was through an administrative arrangement, such as a vetting mechanism of the Central Moneymarket Unit (CMU) of the HKMA, that the Government determined whether a debt instrument was eligible for the tax concession under the QDI scheme.

11. H(MD)/HKMA responded that the CMU/HKMA was only responsible for the lodging of debt instruments and financial derivatives, and was not the authority to determine whether a debt instrument was a QDI. The definition of "debt instrument" for the purpose of the QDI scheme was specified in the relevant provisions of the IRO.

12. At the request of Mr James TO, the Administration would provide information on the criteria and legal backing for determining whether an instrument was a QDI under the existing QDI scheme, and the relevant legislative provision(s) specifying that structured financial products were not QDI under the scheme.

(Post-meeting note: The information provided by the Administration was circulated to members vide LC Paper No. CB(1)2664/09-10 on 28 July 2010.)

Regulatory regime for the debt market

13. In reply to Mrs Regina IP's enquiry on whether the issuance of QDIs had to be approved by the Securities and Futures Commission (SFC), PAS(FS)5 responded that similar to other relevant financial products, the offering documents of debt instruments were subject to the approval of SFC.

14. In view of the emergence of new structured financial products in the market from time to time, and the need to enhance control on the sale of financial products after the global financial crisis, Mr Albert HO expressed concern whether adequate safeguards were in place to regulate the debt market to protect the investing public. Mr HO opined that the Government must first ensure that an effective regulatory regime was in place before giving consideration to further promoting the debt market.

15. In response, PAS(FS)5 said that following the global financial crisis, the Government had been introducing a host of measures to enhance the regulation of

the financial markets, and would consider whether further regulatory measures would be required as appropriate.

Definition of an associate

16. In reply to Mrs Regina IP's enquiry about the definition of "associate" in the context of the QDI scheme, PAS(FS)5 replied that at present the term "associate" was defined in the relevant provisions of the IRO. In drawing up the definition for "associate" in the current legislative proposal for the enhanced QDI scheme, reference would be made to existing definitions in the IRO and the particular circumstances of the QDI scheme. The Deputy Commission for Inland Revenue (Technical) (DCIR(T)) supplemented that as far as the IRO was concerned, an "associate" was defined as a spouse, relative or child of a person, or as a partner, or the partner's spouse or child, of a non-legal entity, or as a subsidiary company of a corporation.

17. Mrs Regina IP requested that the Administration provide supplementary information regarding the definition of an "associate" in the context of the IRO.

(Post-meeting note: The information provided by the Administration was circulated to members vide LC Paper No. CB(1)2664/09-10 on 28 July 2010.)

The "issued to the public" criterion and anti-tax avoidance provision

18. In response to the Chairman's and Mr Paul CHAN's enquiries regarding the proposed amendment to the "issued to the public" criterion, H(MD)/HKMA explained that under the proposed new requirement, the issuer had to check that the debt instrument was not issued to any "associate" if the debt instrument was issued to less than 10 persons at primary launch. If the debt instrument was issued to 10 persons or more, the issuer did not have to check the status of the holders of the debt instrument. If any portion of a QDI was held by an associate of the issuer at any time during the life of the issue, the relevant profits tax concession offered under the QDI scheme would not apply to that portion of the issue.

19. Referring to paragraph 11 of the Administration's paper, the Chairman said that he did not see the need to provide for the requirement of "10 persons or more", given that the requirement of "if less than 10 persons, none of which is an associate of the issuer" was already sufficient for the purpose of defining the "issued to the public" criterion.

Government Bond Programme

20. In response to Mrs Regina IP's enquiry about the updated position of the Government Bond Programme (GBP), PAS(FS)5 said that Government bonds with tenors of two, five and ten years had been issued to institutional investors so far. The Government had been monitoring the market conditions with a view to determining the appropriate timing for launching the retail issue under the GBP.

21. At the request of Mrs Regina IP, the Administration would provide information on the updated position of the GBP, including the original maturity, amounts of bonds issued, the yields from the bonds in comparison with the Exchange Fund notes, and the timetable for issuance of Government bonds to retail investors.

(Post-meeting note: The information provided by the Administration was circulated to members vide LC Paper No. CB(1)2664/09-10 on 28 July 2010.)

Tax concessions relating to "import processing" arrangement

22. Mr Andrew LEUNG said that while he supported the proposed enhancements to the QDI scheme, the Government should review section 39E of the IRO with a view to providing tax concession for machines and plants used under the "import processing" arrangement. PAS(FS)5 took note of the comments and said that the Government would take into account such comments as appropriate in reviewing section 39E of the IRO in due course.

III Implementation of System Infrastructure Enhancement Project for the Inland Revenue Department

(LC Paper No. CB(1)2364/09-10(02) — Administration's paper on "Implementation of System Infrastructure Enhancement Project for the Inland Revenue Department")

23. The Principal Assistant Secretary for Financial Services and the Treasury (Treasury) (PAS(Tsy)) briefed members on the proposed implementation of the System Infrastructure Enhancement (SIE) project of the Inland Revenue Department (IRD), by highlighting the salient points in the paper.

Implementation arrangements

24. Mrs Regina IP declared interest that she did not hold shares of other computer companies except those of Microsoft Corporation. While supporting the SIE project, she noted that the Windows software program used by IRD was not the most updated version and opined that IRD should expedite the project and update its computer systems on a more regular basis. Mrs IP asked whether IRD would consider using cloud-computing system, and software programs other than those provided by Microsoft Corporation. Noting that the SIE project would be completed by 2016, Mrs IP further asked whether the SIE project would be implemented in-house or through out-sourcing, since many vendors including small and medium enterprises (SMEs) would be interested in taking up the project.

25. The Deputy Commissioner (Operations), IRD (DC(O)/IRD) responded that IRD's existing information technology (IT) infrastructure comprised the mainframe, midrange, personal computer (PC) and local area network (LAN) platforms. In upgrading this highly integrated IT infrastructure, it was of pivotal importance to ensure the compatibility of the systems and software programs. Since cloud-computing involved a more open system platform, it might not be suitable for the IRD computer system which required a very high level of security in order to protect the integrity and privacy of taxpayers' data. The Chief Systems Manager (Inland Revenue), IRD (CSM(IR)/IRD) supplemented that in selecting the software programs, consideration had to be given to the adaptability, compatibility and applicability of the programs for development of the IRD computer system. DC(O)/IRD added that the SIE project would be implemented by three stages. The first stage involving upgrading of the file server and workstation infrastructure would be completed by December 2012. The Document Management System would be upgraded during the second stage, ending in March 2013. The migration of mainframe applications to the midrange platform would be implemented during the third stage, which was scheduled for completion in July 2016. The preparation work for the migration process in the third stage had to start immediately in view of the complexity of the work involved. DC(O)/IRD said that an open tendering exercise would be conducted for the SIE project, and all interested contractors, including SMEs, would be welcomed to submit tenders. The selection criteria would include, among other things, the tender price, computer project experience, expertise of the company, etc. IRD had yet to draw up the tender documents. A project steering committee comprising senior IRD officers had been formed, with the support of the Office of the Government Chief Information Officer, to oversee the implementation of the SIE project. The Administration planned to submit a funding proposal to the Finance Committee by the end of 2010.

IV Any other business

Request for discussion of issues relating to transactions of flats at 39 Conduit Road and disclosure of information by the listed property developer

(LC Paper No. CB(1)2330/09-10(01) — Hon James TO's letter on issues relating to transactions of flats at 39 Conduit Road and disclosure of information by the listed property developer (Chinese version only))

26. The Chairman drew members' attention to the documents received prior to the meeting from Henderson Land Development Company Limited (Henderson) and the letters to Henderson issued by the Lands Department tabled at the meeting, relating to the transactions at 39 Conduit Road. The Chairman invited views from members regarding Mr James TO's request for holding a Panel meeting to discuss issues relating to the transactions at 39 Conduit Road.

(Post-meeting note: The letters to Henderson issued by Lands Department and Henderson's reply letters were circulated to members vide LC Paper No. CB(1)2462/09-10 on 6 July 2010, and the letters were uploaded onto the Legislative Council website on the same day.)

27. Mr James TO explained that his request and Mr LI Wing-tat's request for discussion of the 39 Conduit Road incident at this Panel and the Panel on Housing respectively had different focuses. Mr TO said that he was concerned about the legislative control on stock market manipulation activities and incidents such as the property transactions at 39 Conduit Road, or in other words, whether the existing legislation needed to be strengthened in order to deal with dissemination of information of false sales of the stock in trade by listed companies. Given that Members had noted at the House Committee meeting that the Police had initiated investigation into the incident, the Administration should be invited to brief the Panel on the basis and scope of the investigation.

28. The Deputy Chairman said that the incident relating to 39 Conduit Road should be viewed from two perspectives. Given that Henderson was a listed company, its disclosure of company information might have impacted on the share price of the company and other listed companies of the property sector. Any misleading information disclosed by a listed company might lead to fluctuations in the securities market, resulting in losses to some investors. Similarly, if a property company disseminated misleading/false information, property prices might be affected. Since legislation was in place to deal with listed companies disseminating misleading/false information, the Panel might consider whether existing legislation was applicable to false trading in the real estate market. The Deputy Chairman opined that in order to uphold Hong Kong's status as an international financial centre, adequate measures/controls should be put in place to protect investors, and to ensure the transparency and fairness of the securities and property markets. The Deputy Chairman was of the view that the Panel needed to look into the 39 Conduit Road incident and its impact on the securities and property markets. Mrs Regina IP said that she concurred with the Deputy Chairman that a review of the legislation relating to dissemination of misleading/false information by listed and/or property companies should be conducted.

29. Dr Philip WONG stated that the main responsibilities of Legislative Council were to monitor the work and the expenditure of the Government. He opined that supervision of the operation of the private commercial market did not fall within the purview of the Legislative Council. He doubted the suitability for the Panel to discuss the incident, pointing out that the Lands Department was already looking into the case. Dr WONG said that members' main concern should be whether the relevant Government bureau/department and regulatory bodies had acted in accordance with, and/or effectively enforced the relevant legislation in the incident, and whether any amendment to the existing legislation was necessary as revealed after the investigation of the incident. Dr WONG opined that it would set a bad precedent if the Legislative Council investigated an incident involving a private

company. It was also not practicable for the Legislative Council to investigate into each and every incident involving private companies.

30. Mr Abraham SHEK declared interest that he was representing the real estate and construction functional constituency. Mr SHEK shared Dr WONG's view regarding the suitability for the Legislative Council to discuss incidents involving the operation of private companies. He opined that since the Government was looking into the incident and Henderson had already provided the relevant documents to Members, Members might consider discussing the incident after the Government had completed the investigation and when the findings were available. Mr SHEK pointed out that the Panel on Housing would also consider whether it should discuss the incident. Mr SHEK was concerned that a particular company was pinpointed in the incident.

31. Mr Andrew LEUNG echoed Dr WONG's concern and opined that the Legislative Council should not initiate investigation into incidents involving the private sector without fully justifiable grounds, as such actions might adversely affect Hong Kong's status as an international financial centre. Mr LEUNG opined that given that the Government/Police were looking into the case and the SFC had the statutory authority and responsibility of dealing with market manipulation activities, members should be cautious in considering whether the Panel should pursue the case. Mr LEUNG added that he would support discussing the incident at the Panel after the Government/Police had completed investigation of the incident and provided a report on the findings, with a view to reviewing the need for adjusting the existing policy and/or amending the relevant legislation. Mr Abraham SHEK shared Mr LEUNG's view and added that all investigation had to be based on evidence, and the Government/Police should be given the time to conduct their investigation.

32. Ir Dr Raymond HO said that based on the experience of the committees looking into issues relating to the Lehman Brothers Minibonds Incident and the post-service employment of Mr LEUNG Chin-man, caution should be exercised by Members in initiating any inquiry into an incident which involved private companies, as it might discourage foreign investors from establishing their enterprises and/or invest in Hong Kong. Ir Dr HO pointed out that the Government and the regulatory bodies were responsible for enforcing the legislation regarding dissemination of misleading/false information and/or market misconduct. Ir Dr HO opined that it might be premature for the Panel to discuss the 39 Conduit Road incident at this juncture when the Government/Police were still investigating the case, and it would be appropriate for the Panel to discuss the issues relating to the incident when an investigation report was available.

33. Mr Jeffrey LAM said that since there were views and speculations reported in the media from time to time about private transactions, great care should be taken by Members in considering whether the Legislative Council should look into particular incidents involving private transactions, particularly if such inquiries involved invoking the powers under the Legislative Council (Powers and Privileges)

Ordinance (Cap. 382). Mr LAM opined that as the Government was looking into incident and had yet to make a report, it would not be appropriate for the Panel to discuss the incident at this juncture.

34. Mr James TO said that he had not mentioned in his letter about invoking the powers under Cap. 382 for discussion of the incident, and no member of the Panel had made such a suggestion.

35. Mrs Regina IP said that members should not take it lightly in suggesting the invocation of the powers under Cap. 382, since it would incur substantial manpower and resources if the powers were to be invoked in an inquiry, as demonstrated in the inquiry into the Lehman Brothers Minibonds Incident.

36. Mr James TO expressed grave concern that in page 2 of its letter to the Lands Department dated 10 May 2010, Henderson stated that according to the information obtained from some bankers, HKMA did not seem to have made any distinction in respect of the provisional sale and purchase agreements entered into before or after 23 October 2009 when it directed a tightening of the lending policy to the banks in respect of 39 Conduit Road. Henderson said that the company was advised by the banks that even a loan enquiry on 39 Conduit Road received by a bank needed to be immediately reported to the HKMA. Many banks referred to the granting of mortgages on 39 Conduit Road as a "sensitive" issue, rather than a pure commercial decision. Mr TO said that HKMA should clarify whether it had given directions to banks as described in the company's letter; if yes, the rationale for such directions; and whether the directions were consistent with HKMA's policies and established practices in supervision of banks.

(Post-meeting note: The letter to HKMA was issued to members vide LC Paper No. CB(1)2482/09-10(02) on 7 July 2010 and the reply from HKMA was circulated to members vide LC Paper No. CB(1)2612/09-10(02) on 21 July 2010 .)

37. Mr KAM Nai-wai pointed out that previously the Panel had discussed the regulatory issues arising from a particular incident, e.g. the Citic Pacific incident and the listing of Asian Citrus Holdings Limited by introduction. Mr KAM opined that as the sale of the flats at 39 Conduit Road at sensational prices had a significant impact on the profits of the listed property company and its share prices, the relevant Government bureau and regulatory bodies should be invited to brief the Panel on the actions taken and to be taken on the incident.

38. The Deputy Chairman was concerned whether the sale and purchase (S&P) agreements concerned were legally binding on both parties to effect the sale of the flats to the buyers. Noting that the documents provided by Henderson to Members only included the transaction cancellation agreements, the Deputy Chairman opined that unless the S&P agreements were also provided to Members, a meaningful discussion of the issue would not be possible. He pointed out that the S&P

agreements registered with the Land Registry were public documents, and could be provided to Members without the Panel having to invoke the powers under Cap. 382.

39. Mrs Regina IP said that since the documents from Henderson and the Lands Department were provided only prior to and during the meeting, she would need more time to study the documents. Mrs IP pointed out that many people had expressed concern about the impact of the sale of flats at 39 Conduit Road at sensational prices on the prices of nearby properties resulting in many buyers having to pay higher prices for their flats.

40. The Chairman recapitulated that Mr James TO had requested in his letter dated 18 June 2010 that the Panel should hold a meeting to discuss issues relating to the transactions of flats at 39 Conduit Road and disclosure of information by the listed property developer, with the attendance of the Administration and other concerned parties, and that the Administration and Henderson had provided to Members copies of their relevant correspondence. The Chairman invited members to vote on Mr TO's proposal to hold a meeting at this stage to discuss the relevant issues. 5 members voted for the proposal and 7 members voted against the proposal. The Chairman said that given the voting result, the Panel would not, at this stage, discuss the subject.

41. Mr James TO and Ms Starry LEE said that, to address members' concerns, the Administration should be requested to provide information about the applicability of any existing statutes or rules to the incident, e.g. the disclosure requirements for price sensitive information by listed companies.

(Post-meeting note: The letter to the Administration was issued to members vide LC Paper No. CB(1)2482/09-10(01) on 7 July 2010, and the Administration's replies were circulated to members vide LC Paper No. CB(1)2597/09-10(01) and CB(1)2655/09-10 on 19 and 27 July 2010 respectively.)

42. There being no other business, the meeting ended at 12:30 pm.

Council Business Division 1
Legislative Council Secretariat
17 August 2010