

立法會
Legislative Council

LC Paper No. CB(1)906/10-11
(These minutes have been seen
by the Administration)

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Panel on Financial Affairs

Minutes of meeting
held on Monday, 1 November 2010 at 9:00 am
in the Chamber of the Legislative Council Building

- Members present :**
- Hon CHAN Kam-lam, SBS, JP (Chairman)
 - Hon CHAN Kin-por, JP (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 Emily LAU Wai-hing, JP
 - Hon Abraham SHEK Lai-him, SBS, JP
 - Hon Vincent FANG kang, SBS, JP
 - Hon LEE Wing-tat
 - 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 Mrs Regina IP LAU Suk-ye, GBS, JP
- Members absent :**
- Hon Ronny TONG Ka-wah, SC
 - Hon Paul CHAN Mo-po, MH, JP

Public officers attending : Agenda Item IV

Mr Norman CHAN, SBS, JP
Chief Executive
Hong Kong Monetary Authority

Mr Peter PANG, JP
Deputy Chief Executive (Development)
Hong Kong Monetary Authority

Mr Eddie YUE, JP
Deputy Chief Executive (Monetary)
Hong Kong Monetary Authority

Mr Arthur YUEN, JP
Deputy Chief Executive (Banking)
Hong Kong Monetary Authority

Agenda Item V

Mr John LEUNG, JP
Deputy Secretary for Financial Services and the
Treasury (Financial Services)

Mr Nick AU YEUNG
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)

Ms Ada CHUNG, JP
Registrar of Companies
Companies Registry

Mr CHUNG Wai-tim
Senior Solicitor (Company Law Reform)
Companies Registry

Agenda Item VI

Mr Kenneth CHAN
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)

Agenda Item VII and VIII

Miss Cathy CHU, JP
Deputy Secretary for Financial Services and the
Treasury (Treasury)²

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

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

Mr CHIU Kwok-kit, JP
Assistant Commissioner of Inland Revenue (2)

Attendance by invitation : Agenda Item VI

Mr Keith LUI
Executive Director, Supervision of Markets
Securities and Futures Commission

Mr Rico LEUNG
Senior Director, Supervision of Markets
Securities and Futures Commission

Mr Derrick FUNG
Senior Vice President and Head of Clearing
Hong Kong Exchanges and Clearing Limited

Mr James WONG
Vice Chairman
Federation of Share Registrars Limited

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

Staff in attendance : Mr Noel SUNG
Senior Council Secretary (1)4

Ms Haley CHEUNG
Legislative Assistant (1)8

Action

I Confirmation of minutes of meeting and matters arising

(LC Paper No. CB(1)130/10-11 — Minutes of the meeting on 14 October 2010)

The minutes of the meeting held on 14 October 2010 were confirmed.

II Information papers issued since the last regular meeting on 5 July 2010

(LC Paper No. CB(1)2449/09-10(01) — Administration's information note on "Government injection of contribution exercise - Summary Report"

LC Paper No. CB(1)2479/09-10(01) — List of outstanding follow-up actions for the Panel and Administration's response on tobacco duty, depreciation allowances under "import processing" arrangements and tax appeal mechanism

LC Paper No. CB(1)2608/09-10(01) — Administration's paper on second quarterly report of 2010 on Employees Compensation Insurance — Reinsurance Coverage for Terrorism

LC Paper No. CB(1)2613/09-10 — Hong Kong Monetary Authority's information folder containing materials about the launch of a new

series of Hong Kong banknotes

- LC Papers No. CB(1)2633/09-10(01) — Submission from a member and CB(1)2743/09-10(01) of the public dated 8 July 2010 concerning the regulation of leveraged foreign exchange activities and Hong Kong Monetary Authority's reply
- LC Papers No. CB(1)2676/09-10(01), — Administration's summary (02) and (03) note and publication on "Hong Kong Population Projections 2010-2039", and a publication entitled "Hong Kong Life Tables 2004-2039"
- LC Paper No. CB(1)2685/09-10(01) — Referral from the Complaints Division of the Legislative Council Secretariat concerning the regulation of the sale of complex and high risk investment products
- LC Paper No. CB(1)2742/09-10(01) — Second Quarter Economic Report 2010 and the press release
- LC Papers No. CB(1)2793/09-10(01) — Hon Mrs Regina IP's letter and (02) dated 5 August 2010 regarding the HKMC and HKMC's response
- LC Paper No. CB(1)3029/09-10(01) — Process Review Panel for the Securities and Futures Commission Annual Report to the Financial Secretary for 2009-2010
- LC Papers No. CB(1)113/10-11(01) — Submission from a member

and (02) of the public dated 25 and 26 September 2010 regarding assessment of properties tax and the Administration's response

LC Paper No. CB(1)114/10-11(01) — Submission from a member of the public dated 29 September 2010 regarding the assessment of rates

LC Paper No. CB(1)241/10-11(01) — Administration's paper on third quarterly report of 2010 on Employees Compensation Insurance — Reinsurance Coverage for Terrorism)

2. Members noted the information papers issued since the last regular meeting held on 5 July 2010.

III Date of next meeting and items for discussion

(LC Paper No. CB(1)217/10-11(01) — List of outstanding items for discussion

LC Paper No. CB(1)217/10-11(02) — List of follow-up actions)

3. The Chairman suggested and members agreed that the following four agenda items would be discussed at the meeting on 29 November 2010, which would start at 9:00 am:

- (a) Briefing by the Financial Secretary on Hong Kong's latest overall economic situation;
- (b) 2011-2012 Budget consultation;
- (c) Extension of a supernumerary directorate post in the Financial Services Branch to coordinate the anti-money laundering (AML) matters; and

- (d) Treatment of accrued benefits derived from mandatory contributions for Mandatory Provident Fund (MPF) in case of bankruptcy of the scheme member.

4. The Chairman said that Mr WONG Kwok-hing had suggested to him that the Panel should hold a meeting to further discuss the issues relating to the collection and use of customers' personal data by the Octopus Holdings Limited (OHL) / its subsidiaries companies, having regard to the reports issued by the Privacy Commissioner for Personal Data (PCPD), the special committee appointed by the OHL Board of Directors and the independent auditor Deloitte Touche Tohmatsu (DTT) on the incident. A possible arrangement was to hold another Panel meeting on 6 December 2010 to discuss the "Octopus" incident. He would inform members of any new development.

IV Briefing on the work of Hong Kong Monetary Authority

(LC Paper No. CB(1)217/10-11(03) — Hong Kong Monetary Authority (HKMA)'s paper on global and Hong Kong financial and economic conditions and its work)

5. At the invitation of the Chairman, the Chief Executive, Hong Kong Monetary Authority (CE/HKMA) gave a Powerpoint presentation on global and Hong Kong financial and economic conditions, and the work of the HKMA.

(Post-meeting note: The Chinese and English version of the notes of the Powerpoint presentation were issued to members vide Lotus Notes e-mail on 1 and 10 November 2010 respectively.)

Property market

6. Mr Andrew LEUNG was concerned that, despite the measures introduced by the Government to counteract the heated property market, indications were that the prices of properties would continue to rise after a short stabilisation in September 2010. Mr LEUNG asked what further measures HKMA would take to address the risks of a property bubble, and whether the Government would consider differentiating its policy to forestall the heated property market for properties valued more than and lower than \$2.5 million, so as to facilitate first-time purchasers to buy their properties. Mr KAM Nai-wai expressed similar concerns. Noting that the Government would introduce appropriate measures to counteract the heated property market as and

when necessary, Mr KAM enquired what further measures would be taken, e.g. whether the maximum loan-to-value ratio for properties valued under \$12 million would be lowered from 70% to 60%, and what indicators were used by the Government in considering the timing for introducing such measures.

7. CE/HKMA responded that several indicators were used to assess whether the property market was over-heated. These indicators included, among other things, the number of transactions, the property prices, the number and amount of mortgage loans granted by banks. The Administration and HKMA were cautious in introducing measures to address property bubble risks, as any such measures might deprive the opportunity of some buyers who might otherwise be able to purchase their flats for self-use. The Government had to strike a balance between regulating the market and ensuring the healthy development of the property market so that purchasers who had a genuine need could continue to buy their flats. The Deputy Chief Executive(Banking)/HKMA (DCE(B)/HKMA) supplemented that a major concern of HKMA at this stage was whether the measures introduced by HKMA in August 2010 had been duly implemented by banks and whether the measures were effective in stabilizing the heated mortgage market. DCE(B)/HKMA added that HKMA had advocated the establishment of a positive credit database on mortgage loans, but owing to privacy considerations, such a database had yet to be set up. He pointed out that a positive mortgage credit database was essential for the risk management of banks, and other jurisdictions already had established similar databases.

8. Mr LEE Wing-tat opined that it would take time to increase land supply and/or impose a higher stamp duty in order to curb speculative activities in the property market. Mr LEE was of the view that consideration should be given to further lowering the maximum loan-to-value ratio for properties purchased by companies and individuals holding more than one property, as such properties were usually purchased for speculation purpose. Mr LEE said that purchasers holding more than one property could be easily identified from the Land Registry records. Mr LEE was concerned that many property developers would provide a secondary mortgage loan to buyers. He questioned whether any stress test had been conducted by those property developers providing secondary mortgage loans.

9. CE/HKMA responded that the property ownership records maintained by the Land Registry were based on the address of the property and search of records of properties using names of owners would not be feasible. CE/HKMA pointed out that the borrower's Debt Servicing Ratio (DSR) was calculated based on the total debt liabilities of the borrower, therefore covering secondary mortgage loans provided by property developers. DCE(B)/HKMA supplemented that the maximum loan-to-value ratio for non-owner-occupied

properties had been lowered to 60% under the new guidelines issued to Authorised Institutions (AIs) in August 2010.

10. Referring to the recent political and economic circumstances of the United States (US) and the high volatility of the world's major financial markets, Ms Emily LAU enquired what advice CE/HKMA would give to Hong Kong people in face of the unusual economic circumstances.

11. CE/HKMA responded that asset prices were subject to cyclical changes, and would be affected by a number of factors. People who believed that the upward trend of property prices would continue infinitely would tend to ignore warning signals. The role of HKMA was to maintain the stability of Hong Kong's banking system, and the measures introduced by the HKMA in August 2010 aimed to strengthen banks' risk management on residential mortgage lending, and would help potential property buyers to assess the risks involved prudently, as the low interest rate environment would not continue perpetually.

12. Mrs Regina IP was concerned that Hong Kong, being an open economy, would suffer seriously if there was a reversal of the low interest trend and an abrupt outflow of large amount of capital, in view of the unusual economic situation in the US and the global economy. Pointing out that other jurisdictions such as Australia and Brazil had already introduced decisive measures to counteract the formation/growth of asset bubbles, Mrs IP asked what measures would be taken by the Government/HKMA to address the risks of asset bubbles.

13. CE/HKMA responded that similar to Hong Kong, many Asian economies such as Singapore, Korea, Taiwan and Australia were also facing the impact of the quantitative easing policy of the more advanced markets, notably the influx of huge amount of capital and the consequential surge in asset prices. Economies with fixed or floating exchange rates experienced similar problems. Various economies had taken different steps to meet these challenges based on the specific conditions of their political and economic systems. For instance, Australia had taken the unusual step of restricting the purchase of properties by non-residents. To counteract the effects of quantitative easing measures, the Brazilian government had imposed a special tax on foreign investment on bonds. Being a small and open economy, Hong Kong could not use some of the tools available to other economies to counteract the impact of quantitative easing, such as restricting the inflow and outflow of capital, as the Basic Law stipulated that the Government shall safeguard the free flow of capital within, into and out of Hong Kong. The Financial Secretary (FS) had said that the SAR Government would closely monitor the situation and would take appropriate steps to prevent the formation of a property market bubble. CE/HKMA said that the measures introduced by

the Government and HKMA to forestall the heated property market in August 2010 had taken effect in September but the property market seemed to become exuberant again from mid-October. HKMA would need more time to assess the market situation, and would take further steps to enhance banks' risk management as and when necessary. At the request of Mrs Regina IP, CE/HKMA agreed to provide information on the measures taken by the governments of other economies (including Singapore, Brazil and Australia) to cope with the risk of a property market bubble.

(Post-meeting note: HKMA's response was circulated to members vide LC Paper No. CB(1)571/10-11 on 26 November 2010.)

14. Mr Albert HO remarked that the measures introduced by the Government so far and the warnings given by the principal officials regarding the risks of a property market bubble did not appear to have effectively averted the heated property market. Given the Linked Exchange Rate System and the free flow of capital in and out of Hong Kong, he asked whether the tools available for the Government/HKMA to forestall the heated property market were limited. Mr HO further asked what further measures HKMA and the Government could take to cope with the risks of a property market bubble, and whether the Government would consider counteracting the heated property market by means of taxation.

15. CE/HKMA responded that under the Linked Exchange Rate System, Hong Kong did not have the flexibility of using interest rate policy to cool down the market. However, the HKMA had been using a focussed approach by enhancing prudent risk management on mortgage lending, which would help constrain the availability of bank credit for the property market. In addition, the FS had also reaffirmed the readiness to take other appropriate measures to mitigate against the risks of a property market bubble. The suggestion of imposing taxes to cool the property market would be relayed to FS and the relevant Bureau for consideration.

16. Dr LAM Tai-fai expressed concern that a property market bubble was already emerging as large amounts of hot money continued to flow into Hong Kong in October. Dr LAM asked whether HKMA could provide professional advice to Hong Kong people who had a genuine need to buy a flat as to when the interest rate would pick up an upward trend, and the timing when a property bubble would be formed and burst.

17. CE/HKMA responded that the macro financial environment as well as the asset markets were changing all the time, and it would be difficult, if not impossible, to precisely predict the movement of the markets at specific junctures. For instance, the value of the US dollar and the Euro fluctuated

significantly in the past months. While the interest rates for mortgage loans remained extremely low at present, an upward trend might resume at any moment due to factors such as risk aversion by investors.

18. Mr James TO opined that given the market information on monetary affairs accessible by the top officials in HKMA, the CE/HKMA should provide in-depth analyses of the latest development and anticipated trends of financial markets for Members. Mr TO said that the former CE/HKMA used to provide an analytical assessment of the global and local financial situations in his briefings, and revealed possible measures to deal with the challenges posed by the changing financial market.

19. CE/HKMA responded that in his statement made in August 2010, FS had already announced several measures not related to prudential supervision to tackle the heated property market, covering issues such as land supply. The authority to formulate these policies vested with FS and the relevant Bureau and was outside the purview of HKMA. At the same time, the HKMA had introduced measures to strengthen banks' risk management on residential mortgage lending with a view to maintaining the stability of the banking system.

20. The Chairman concurred that there was a need to strengthen banks' credit risk management in face of the current global economic situation. In this connection, he enquired whether consideration would be given to further lowering the borrowers' DSR to 40% in order to strengthen risk management of AIs.

21. CE/HKMA responded that strengthening the risk management of banks was also conducive to protection of homebuyers' interests, but inevitably some genuine end-users with marginal financial capability might be affected. So it would be necessary to strike the right balance in tightening banks' underwriting standards. The HKMA would regularly review the various measures for maintaining the stability of the banking system, including the appropriate level of DSR of borrowers.

Positive credit data

22. In view of the upsurge of property prices in the past year or so, Ms Starry LEE expressed concern about the absence of any arrangement for the sharing of positive credit data on mortgage loans among banks. She understood that such arrangement would unlikely be implemented until early 2011. She enquired about the reasons for the slow progress in the matter.

23. CE/HKMA concurred with Ms Starry LEE that there was an urgent need to set up a mechanism for sharing of positive credit data on mortgage loans among banks. CE/HKMA pointed out that currently an applicant for a mortgage loan had to make a declaration to the AI concerned as to whether he had taken out mortgage loans with other AIs, and provide details of such loans. CE/HKMA remarked that when he took up his post in 2009, he immediately initiated discussions with PCPD on setting up a central positive credit database on mortgage loans, and FS had also written to PCPD earlier this year highlighting the urgency of the matter. CE/HKMA pointed out that before the data sharing arrangement could be implemented, it would take some time for PCPD to revise the relevant privacy code, and for AIs to adjust their computer systems. HKMA would continue to liaise with PCPD and would accord priority to the issue with a view to setting up the positive credit data sharing mechanism for mortgage loans in early 2011.

24. At the request of Ms Starry LEE, DCE(B)/HKMA undertook to provide information on whether there were past cases involving applicants providing false information on their existing mortgages in applying for mortgage loans.

(Post-meeting note: HKMA's response was circulated to members vide LC Paper No. CB(1)571/10-11 on 26 November 2010.)

Global economic situation and Basel III requirements

25. Mr Andrew LEUNG enquired whether the implementation of the second round quantitative easing measures (QE2) by the US Federal Reserve would lead to a currency war, and the impact of QE2 on Hong Kong's economy, especially on inflation and the property market.

26. Ir Dr Raymond HO enquired as to how CE/HKMA would describe the current global economic situation, as European countries such as Greece, Italy, Ireland and Spain still faced serious sovereign debt problems, and the US Federal Reserve would introduce QE2 shortly.

27. CE/HKMA responded that the present global economic situation was very unusual. After the outbreak of the global financial crisis triggered by the

collapse of the US subprime market and followed by the sovereign debt problem in Europe, various governments had introduced measures to stabilise their financial markets, but the momentum for economic recovery seemed to have weakened since the first half of this year. Meanwhile, economic recovery in emerging markets in Asia was robust. The divergent pace of economic recovery in different regions had led to abnormal movement of capital and the QE2 would put further pressure on the capital markets in Asia. As there was an imbalance in global financial markets, the influx of capital had led to upsurge of property prices in recent years in places like Hong Kong, Taiwan, Singapore and Australia. CE/HKMA said that while there were a lot of controversies surrounding the value of currencies and trade imbalances, historical data showed that there was no direct link between the value of a currency and trade surplus/deficit in the medium to long term. For instance, despite the appreciation of Renminbi of about 17% to 18% between 2005 and 2009, the trade surplus of China with the US continued to grow.

28. Noting that Basel III had tightened the definition of regulatory capital, increased the minimum requirement for Tier 1 capital, and established conservation / countercyclical capital buffers, Ir Dr Raymond HO enquired about the follow-up actions to be taken by Hong Kong in compliance with the Basel III requirements, including the introduction of a non-risk based leverage ratio, a new liquidity coverage ratio and a net stable funding ratio.

29. DCE(B)/HKMA responded that the AIs had no difficulty in complying with the tighter capital requirements set under Basel III because they had always been well-capitalised and maintained strong liquidity. The only area that Hong Kong might face some difficulties was in relation to the liquidity coverage ratio because there was a limited supply of public debt instruments in Hong Kong. HKMA was discussing with the Basel Committee on Banking Supervision regarding the situation in Hong Kong, and the aim was to identify a possible by the end of 2010.

Reverse mortgage

30. In response to Ms Emily LAU's enquiry about the provision of reverse mortgage for the elderly, DCE(D)/HKMA said that the Hong Kong Mortgage Corporation (HKMC) was actively studying the issue, and the arrangements involved were quite complicated. DCE(D)/HKMA said that focus group meetings had been held recently to hear the views of the elderly, and a general survey with a survey size of about 1 000 persons would be conducted in the fourth quarter of 2010 to gauge the views of the stakeholders. Discussions had been focused on certain major areas, such as the amount of monthly instalments paid to the property owner, the feasibility of paying a higher monthly instalment for a shorter period and whether the spouse of the property owner

should be allowed to receive the monthly instalment after the decease of the owner. CE/HKMA added that after the collected views had been analysed, the Panel would be briefed on whether the reverse mortgage proposal would be pursued further.

Small and medium-sized enterprises

31. Mr Jeffrey LAM was concerned that the Special Loan Guarantee Scheme (SLGS) introduced after the global financial crisis would expire at the end of 2010. In view that HKMC was considering the introduction of a loan guarantee scheme for small and medium sized enterprises (SMEs), Mr LAM enquired about the timing for introducing the scheme and the percentage of loan guarantee provided.

32. CE/HKMA responded that the SLGS introduced after the outbreak of the global financial crisis had helped ease the credit crunch faced by SMEs, and preserve thousands of jobs. In response to the request of SMEs, HKMC was studying the possibility of introducing a new loan guarantee scheme for SMEs after the SLGS expired at the end of 2010. DCE(D)/HKMA supplemented that the SMEs and banks considered that it was appropriate for HKMC to provide a loan guarantee scheme for SMEs, with a view to offering loan guarantee for the enterprises in more flexible terms. The Board of Directors of HKMC would discuss the detailed arrangements shortly.

Linked exchange rate

33. Mr James TO enquired whether HKMA had conducted any analysis on the impact of abolishing or changing the Linked Exchange Rate System. CE/HKMA said that in the past 27 years, the Linked Exchange Rate System had proved to be effective in maintaining the stability of the financial system of Hong Kong, and there was no need and no plan to change the system. CE/HKMA pointed out that places where the local currency was not pegged to the US dollar or other currencies, such as Australia, Singapore and Taiwan, were also facing similar pressure on inflation and asset price bubbles. A removal of the Linked Exchange Rate System in Hong Kong might actually result in even stronger influx of hot money, leading to higher inflation and asset prices. The Chairman remarked that given that Hong Kong was a small and open economy susceptible to influences of outside market forces, the Linked Exchange Rate System should not be abolished or changed.

V Companies Ordinance Rewrite

Companies Ordinance rewrite

LC Paper No. CB(1)214/10-11 — Background brief on Companies Ordinance rewrite prepared by the Legislative Council Secretariat)

34. The Deputy Secretary for Financial Services and the Treasury (Financial Services) (DS(FS)) briefed members on the latest progress of the Companies Ordinance rewrite exercise and the conclusions of the two phases of consultation on the draft Companies Bill (CB), by highlighting the salient points in the paper.

Disclosure of residential addresses of directors and identification numbers of directors and company secretaries

35. Mr James TO was concerned that if only the service address, and some digits of the Hong Kong Identity Card (HKID) numbers of company directors were shown on the Companies Registry's (CR) public register, there might be identification problem, e.g. several people might have the same name. Mr TO disagreed with the proposal for removal of the directors' residential addresses currently on the public register, as the records might be related to other documentation, and could be useful in certain circumstances.

36. DS(FS) responded that under the current proposal, the existing records on the public register would not be automatically purged. A company director who wanted to purge his residential address or his full HKID number from certain documents in the public register maintained by the CR might make an application and pay a fee for the purging of the records. CR could consider imposing certain conditions under which the existing records could be purged upon application and payment of a fee.

General

37. Ms Starry LEE remarked that given the large number of proposed amendments in the rewrite exercise, the stakeholders might not be able to fully comprehend the detailed proposals and the underlying rationales. Ms LEE enquired what legislative amendments had been proposed to respond to the demand for better protection of the interests of the minority shareholders of a company. Ms LEE pointed out that some minority shareholders had experienced difficulty in obtaining information and records from the company when there was a conflict between the majority and minority shareholders.

38. DS(FS) responded that one of the major objectives of the rewrite exercise was to enhance protection of the interests of the minority shareholders, and the enhancement proposals were made in different sections of the draft CB. For example, the directors' general duties of care would be codified. Shareholders' engagement in the decision-making process and their participation in the company's business would be enhanced, as the threshold requirement for shareholders to demand a poll at a company's general meeting would be reduced from 10% to 5% of the total voting rights. Rules on directors' self-dealing and connected transactions would also be strengthened. DS(FS) remarked that the provisions for remedies for protection of companies' and members' interests were specified in Part 14 of the draft CB. The Registrar of Companies (RoC), CR supplemented that section 98 of the Companies Ordinance (CO) (Cap. 32) provided for shareholders to inspect the register of members of companies, whereas section 120 of CO provided for shareholders to inspect the records of general meetings of companies. When the CO was amended in 2004, provisions were added to the Ordinance to allow shareholders to apply to court for inspection of a company's records. Provisions were presently included in the draft CB to enable shareholders to inspect other records, including proxy and voting documents, and to require a company to record the voting results in the minutes of general meetings and disclose the minutes to shareholders.

VI Joint consultation conclusions on a proposed operational model for implementing a scripless securities market in Hong Kong

(LC Paper No. CB(1)217/10-11(05) — Administration's paper on the consultation conclusions on a proposed operational model for implementing a scripless securities market

LC Paper No. CB(1)215/10-11 — Background brief on proposal to implement a scripless securities market in Hong Kong prepared by the Legislative Council Secretariat)

Briefing by Securities and Futures Commission

39. The Executive Director, Supervision of Markets, Securities and Futures Commission (ED(SM)/SFC) and the Senior Director, Supervision of Markets, SFC briefed members, through a Powerpoint presentation, the consultation

conclusions published by the Working Group on scripless securities market regarding the proposed operational model for implementing a scripless securities market in Hong Kong.

(Post-meeting Note: The presentation slides were issued to members vide a Lotus Notes e-mail on 1 November 2010.)

Discussion

40. While supporting the scripless initiative, Mrs Regina IP enquired about the practice in other major financial markets, such as the US, United Kingdom (UK), Australia and Singapore, and the merits and demerits of the proposed operational model for Hong Kong, in comparison with the operational models in other countries. Mrs IP further enquired about the impact of the scripless initiative on shares transacted in "dark pool", and the arrangements to compensate investors for the scripless securities held in the name of a bank or a securities company when the bank/ securities company went bankrupt.

41. ED(SM)/SFC responded that the stock market in Australia had become fully scripless since 1999. The UK stock market adopted a dual system despite the introduction of scripless securities since 1996, and about 9 million investors still possessed paper share certificates. The US stock market was still paper based, although many of the share certificates were immobilised. The Singaporean stock market was immobilized. The stock market in Taiwan had introduced scripless securities several years ago, and was in the process of consulting market participants regarding the feasibility of a fully scripless securities market. The stock market in the Mainland was totally scripless. The proposed arrangements for Hong Kong were mainly based on the practice of the UK and Australia stock markets. ED(SM)/SFC added that the efficiency and competitiveness of Hong Kong's stock market would be enhanced when scripless securities were introduced, which would also help meet the requirements of the future expansion of the stock market. ED(SM)/SFC said that in the event that a bank/securities company went bankrupt, the records of the bank/company would be checked to ascertain the ownership of the shares, and the proposed use of unique identification numbers for investors would facilitate the verification of the beneficial owners of the shares. As far as the shares traded in "dark pool" were concerned, the introduction of scripless securities would not affect the transactions conducted in the "dark pool" and the relevant shares would be cleared, settled and registered in the Central Clearing and Settlement System (CCASS).

42. Ms Starry LEE was concerned that the scripless initiative would be implemented progressively, and listed companies would be allowed to take up the scripless option on a voluntary basis. Ms LEE enquired about the main

reason that companies would not opt for the scripless operational model. Ms LEE was concerned that it would take a very long time before a fully scripless securities market would be established if companies were allowed to adopt the scripless operational model on a voluntary basis. She opined that all companies seeking to be listed should be required to adopt the scripless operational model.

43. ED(SM)/SFC responded that the scripless operational model was a new initiative, and initially, listed companies would be allowed to offer the scripless securities option to their shareholders. After the dual system had operated for some time, and when market participants considered that the scripless operational model was convenient and cost-effective, consideration would be given to implementing the scripless regime on all listed companies. During the Initial Public Offer of shares, the companies concerned would be required to provide the option of scripless securities to the subscribers. The Chairman remarked that investors should be given the option to hold their shares in the paper form or scripless form.

44. The Chairman enquired whether incentives would be provided to encourage investors to hold their shares in the scripless form, such as allowing investors to open their scripless securities accounts in the CCASS, and transferring their securities from the paper based accounts to the new accounts free of charge. The Chairman opined that, where appropriate, the legislative proposals should include incentives for market participants to use the scripless operational model.

45. ED(SM)/SFC responded that the Hong Kong Exchanges and Clearing Limited and the Federation of Share Registrars would consider means to encourage market participants to use the scripless operational model. SFC would launch educational programmes to familiarise market participants with the scripless regime. As regards the fees to be imposed under the scripless operational model, certain fees of Hong Kong Exchanges and Clearing Limited and share registrars would be subject to SFC's approval whilst banks and securities companies would be subject to market forces in setting their fees level.

46. Mr James TO was concerned about the safeguards to protect the security of the data on scripless securities held inside CCASS, and enquired about the measures to ensure the integrity of the electronic data. Mr TO opined that the level of security of Hong Kong's stock market computer systems should be in line with, or even higher than, the international standard which could resist any attack from hostile parties, especially as part of a warfare, or Hong Kong's economy would be under threat by such attacks.

47. ED(SM)/SFC responded that the Hong Kong Exchanges and Clearing Limited was taking steps to enhance the security of its computer systems in order to ensure the stability and reliability of the securities clearing and data storage systems. SFC would provide input in the design of the scripless securities systems and security of the systems would be a priority concern.

VII Legislative proposals to provide profits tax deduction for capital expenditure on intellectual properties

(LC Paper No. CB(1)217/10-11(06) — Administration's paper on legislative proposals to provide profits tax deduction for capital expenditure on intellectual properties

LC Paper No. CB(1)216/10-11 — Background brief on proposed profits tax deduction for capital expenditure on intellectual property rights prepared by the Legislative Council Secretariat)

48. The Deputy Secretary for Financial Services and the Treasury (Treasury) 2 (DS(Tsy)2) introduced the item. She said that to promote wider application of intellectual properties (IPs) by enterprises, and to facilitate development of creative industries in Hong Kong, the Financial Secretary announced in the 2010-2011 Budget that profits tax deduction would be provided for capital expenditure on three types of IPs, namely registered trade marks, copyrights and registered designs. The proposed tax deduction would be effected through amendments to the Inland Revenue Ordinance (Cap. 112) (IRO).

49. DS(Tsy)2 further said that to be eligible for the profits tax deduction, taxpayers should have acquired the proprietary interest of the relevant IPs and that the IPs were for use in Hong Kong in the production of chargeable profits. Where an IP was used partly outside Hong Kong and/or partly in the production of chargeable profits, deduction would only be allowed for the portion of capital expenditure that was relevant to the use of that IP in Hong Kong for production of chargeable profits. Where an IP was owned by more than one taxpayer, tax deduction would be proportional to the taxpayers' share or interest in the IP. The deduction would be spread over five succeeding years on a straight-line basis starting from the year of purchase. Similar to other tax concession arrangements, measures would be put in place to guard against

possible tax avoidance. The Administration planned to introduce the relevant legislative amendments into the Legislative Council in the latter half of the 2010-2011 legislative session.

50. Mrs Regina IP asked what practical benefits the proposed tax deduction measure would bring, as the existing system already provided tax deduction for expenses related to the creation of IPs including registration expenditure of patents and trade marks. The Deputy Commissioner of Inland Revenue (Technical) (DCIR(T)) said that research and development expenditure incurred for the creation of IPs, e.g. copyrights, was currently tax-deductible under the IRO. On the other hand, businesses which acquired IPs instead of developing these intangible assets on their own would not enjoy tax deduction because the related purchase cost was a capital expenditure which was not generally tax-deductible. Nevertheless, exception had been provided for, among others, capital expenditure on one-off acquisition of patent rights and rights to know-how. The current legislative proposal would extend the existing scope of tax deduction to include capital expenditure incurred on the acquisition of the three categories of IPs.

51. Mrs Regina IP referred to the semiconductor industry as an example and said that the creation of a local IP might involve the use of overseas third party IPs. The application of those IPs might require the payment of royalties or other taxes to the relevant overseas tax authorities. She asked if the Administration would negotiate reciprocal taxation arrangements with those countries, e.g. the United States, to provide more relief for Hong Kong's technology firms. DS(Tsy)2 said that the Administration aimed to conclude more double taxation relief agreements and efforts were being made in that regard.

52. Mr James TO was concerned about possible abuse of the proposal. He asked how the Administration could determine whether an acquisition of IPs was merely for tax benefits or not. He explained that a company could argue that it was a commercial decision to buy an IP at a high price which might eventually prove unworthy of the investment. It would be difficult for the Administration to judge whether the transaction was needed for the business or for tax avoidance purpose. Mr TO also commented that while IPs purchased from an associated party would not be tax-deductible, enforcement could be difficult, especially when the associated party was an overseas company where its identity could not be easily verified. He enquired for more details about the measures which were aimed to prevent the possible abuse of the proposed tax deduction.

53. DCIR(T) said that for a genuine business transaction, the purchaser would assess whether the IP was needed for his business and the potential

investment risks. Certainly, the purchase price would be agreed on an arm's length basis with the vendor. One of the methods to prevent exploitation of the proposed tax concession was to exclude transactions between associated parties. DCIR(T) added that the tax deduction for the relevant IPs would be spread over five succeeding years. This would ensure that the relevant IPs were in fact used for the generation of chargeable profits over a period of time during which the possible tax abuse could be monitored. Furthermore, taxpayers were required to declare in their tax returns any transaction that had involved associated parties. Relevant supporting documents might be required to be submitted to prove that the IPs were used for profit generation purposes. DS(Tsy)2 added that IRD would arrange random check and conduct field audits to investigate any further suspected anomalies.

54. Mr James TO asked if a taxpayer was still entitled to the proposed tax deduction or part thereof if the IPs were used only for a short period, or started to be used towards the later part of the five-year period. He also asked whether a taxpayer could claim tax deduction in the beginning years within the five-year period if the IPs did not contribute towards chargeable profits initially. DCIR(T) said that the objective of the tax deduction measure was to provide relief to taxpayers who had incurred capital expenditure on IPs and used the relevant IPs for generating chargeable profits. When considering a deduction claim, IRD would assess the nature of the taxpayer's business and how such expenditure incurred on acquiring the IPs were connected with the taxpayer's profit making activities.

55. Mr TO explained that the IPs might not contribute towards income in the first few years of purchase. He was concerned that the taxpayers might not receive the full benefit if the proposed deduction was to be spread over five years on a straight-line basis. DCIR(T) said that under the existing law, any expenses incurred from a commercial activity might be tax-deductible if it could be proved to be connected with the generation of taxable income, irrespective of whether or not actual profit was generated. The same principle would apply to capital expenditure on IP procurement in the current proposal. A taxpayer who, out of a commercial decision, was willing to pay a price for an IP that was needed for his business should be eligible for a tax deduction claim, whether or not the business turned out to be profitable. To do otherwise would defeat the purpose of encouraging the wider application of IPs.

56. Pointing out that the value of IPs, as intangible assets, was difficult to assess, Mr James TO asked whether a more conservative approach should be adopted in the initial stage so that only half or a certain proportion of the expenditure should be tax-deductible. DS(Tsy)2 said references had been drawn from overseas tax jurisdictions, many of which allowed full deduction of capital expenditure on IPs to be spread over a few years.

57. In response to the Chairman, DCIR(T) said while the tax deduction would be spread out evenly over five succeeding years, IRD might allow the tax deduction be spread over a shorter period for IPs with a lifespan less than five years.

VIII Creation of a supernumerary directorate post in the Inland Revenue Department

(LC Paper No. CB(1)217/10-11(07) — Administration's paper on creation of a supernumerary post of Chief Assessor in the Inland Revenue Department)

58. At the invitation of the Chairman, DS(Tsy)2 briefed members on the staffing proposal, by highlighting the salient points in the paper.

59. Mr James TO queried that the workload generated from the negotiations for Comprehensive Double Taxation Agreements (CDTAs) and the requests for exchange of information (EoI) under concluded CDTAs might not have reached a point warranting the creation of an additional Chief Assessor (CA) post. To facilitate Members to critically assess whether the creation of a CA post was fully justified, Mr TO requested the Administration to provide quantitative information and analysis about the current workload of the existing staff involved in the negotiation work and other initiatives in relation to CDTAs, and the projected workload. Mr TO remarked that based on the information provided in the paper, he would not support the staffing proposal. Ms Emily LAU shared Mr TO's concern, and remarked that the public was concerned about the creation of a number of directorate posts in recent years and it was incumbent upon Members to exercise vigilance in examining staffing proposals.

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60. DS(Tsy)2 explained that generally speaking, the Inland Revenue Department (IRD) needed to take about two months to prepare for CDTA negotiations with another jurisdiction. In preparing for the negotiations, IRD had to consider and conduct research on the taxes of our contracting partners to be covered in a CDTA, the terms of other CDTAs that the contracting partners had signed, and the applicability of the terms under Hong Kong's legislation, with a view to negotiating for the most favourable terms for Hong Kong. The seven IRD officers currently involved in CDTA negotiation work, including two Deputy Commissioners and five Assistant Commissioners, had to undertake other duties. On average, two rounds of meetings had to be held with

the contracting partner in negotiating a CDTA. DS(Tsy)2 said that the Administration would provide the information requested by members.

61. Ms Emily LAU opined that the Administration should give quantitative information regarding the benefits brought to Hong Kong by the signing of the CDTAs. Ms LAU was of the view that many of the benefits were tangible and could be quantified, e.g. the number of new offices/subsidiaries set up in Hong Kong by companies of the contracting partners of CDTAs, although such development might not be attributable solely to the conclusion of CDTAs.

62. DS(Tsy)2 responded that it might be difficult to list out, in quantifiable terms, the benefits brought about by CDTAs. The benefits of CDTAs were widely recognized by many jurisdictions and sectors. With the signing of CDTAs, more overseas companies would be willing to invest in Hong Kong, such as establishing branch offices and/or subsidiary companies in Hong Kong, leading to creation of job opportunities for local people and increased number of visitors. However, it would be difficult to vindicate whether the increase in the number of overseas companies operating in Hong Kong and visitors to Hong Kong was a result of the CDTAs. As the 10 CDTAs adopting the prevailing EoI standard of the Organization for Economic Cooperation and Development were only signed since March 2010 and they had not yet come into force, the economic impact of these agreements had yet to be seen.

63. Mr James TO enquired whether information regarding the amount of taxes saved by Hong Kong residents and enterprises as a result of the signing of CDTAs could be provided. The Deputy Commissioner of Inland Revenue (Technical) ((DCIR(T)) responded that it would be difficult, if not at all impossible, to provide the information requested by Mr TO, as Hong Kong residents and enterprises enjoying tax exemption/reduction as a result of the CDTAs, such as lower taxes on dividends accrued from overseas investments, exemption from the income tax of the contracting partner countries for employment exercised in those countries shorter than the prescribed period, were not obliged to report such benefits to the Government.

64. In reply to Mr James TO's enquiry, DCIR(T) advised that IRD had not received any EoI request under the 10 CDTAs concluded since March 2010, since they had not yet come into force.

65. Ms Emily LAU enquired why, in its CDTA negotiation work, the Administration did not accord priority to Hong Kong's major trading partners. DS(Tsy)2 responded that the Administration had concluded CDTAs with some of its major trading partners, such as the United Kingdom and France. The Administration aimed to negotiate CDTAs with all Hong Kong's major trading partners, but the work had been affected by manpower constraints. With the

creation of the proposed CA post, more efforts could be made to negotiate CDTAs with Hong Kong's trading partners and other jurisdictions.

Admin 66. At the request of Ms Emily LAU, DS(Tsy)2 undertook to provide supplementary information to:

- (a) explain why Hong Kong had not yet signed CDTAs with some of its major trading partners and how the creation of the proposed CA post would speed up the relevant work; and
- (b) elaborate on, with relevant quantitative information if available, the benefits that CDTAs would bring to Hong Kong taxpayers and the overall economy.

IX Any other business

67. There being no other business, the meeting ended at 12:40 pm.

Council Business Division 1
Legislative Council Secretariat
24 December 2010