

**立法會**  
**Legislative Council**

LC Paper No. CB(1)2637/10-11  
(These minutes have been seen  
by the Administration)

Ref : CB1/PL/FA/1

**Panel on Financial Affairs**

**Minutes of meeting**  
**held on Monday, 4 April 2011 at 10:00 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)  
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 WONG Ting-kwong, BBS, JP  
Hon Ronny TONG Ka-wah, SC  
Hon CHIM Pui-chung  
Hon KAM Nai-wai, MH  
Hon Starry LEE Wai-king, JP  
Hon Paul CHAN Mo-po, MH, JP

**Member attending** : Dr Hon PAN Pey-chyou

**Members absent** : Hon Albert HO Chun-yan  
Hon Andrew LEUNG Kwan-yuen, GBS, JP  
Dr Hon LAM Tai-fai, BBS, JP  
Hon Mrs Regina IP LAU Suk-ye, GBS, JP

**Public officers  
attending**

: Agenda Item III

Miss AU King-chi, JP  
Permanent Secretary for Financial Services and the  
Treasury (Financial Services)

Agenda Items III and IV

Mr Patrick HO, JP  
Deputy Secretary for Financial Services and the  
Treasury (Financial Services)

Agenda item V

Ms Sophia KAO  
Chairman  
Financial Reporting Council

Dr P M KAM  
Chief Executive Officer  
Financial Reporting Council

Ms Velma CHEUNG  
Senior Director, Investigation and Compliance  
Financial Reporting Council

Ms. Selene TSOI  
Principal Assistant Secretary for  
Financial Services and the Treasury  
(Financial Services)

**Attendance by  
invitation**

: Agenda Item III

Mrs Diana CHAN  
Managing Director  
Mandatory Provident Fund Schemes Authority

Mr Darren McSHANE  
Executive Director (Regulation and Policy)  
Mandatory Provident Fund Schemes Authority

Agenda Item IV

Ms Annie CHOI, JP  
Commissioner of Insurance

Ms Carol HUI  
Acting Assistant Commissioner of Insurance  
(Policy and Development Division)

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

**Staff in attendance** : Mr Noel SUNG  
Senior Council Secretary (1)5

Mr Hugo CHIU  
Council Secretary (1)5

Ms Clara LO  
Legislative Assistant (1)10

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Action

**I Confirmation of minutes of meeting and matters arising**

(LC Paper No. CB(1)1572/10-11 — Minutes of meeting on  
29 November 2010

LC Paper No. CB(1)1699/10-11 — Minutes of joint meeting on  
18 March 2011)

The minutes of the meetings held on 29 November 2010 and  
18 March 2011 were confirmed.

**II Date of next meeting and items for discussion**

(LC Paper No. CB(1)1748/10-11(01) — List of outstanding items for  
discussion

LC Paper No. CB(1)1748/10-11(02) — List of follow-up actions

LC Paper No. CB(1)1775/10-11(01) — Letter dated 29 March 2011  
from Hon KAM Nai-wai  
(Chinese version only)

### Meeting in May 2011

2. Members agreed to discuss the following items proposed by the Administration at the next regular meeting scheduled for 5 May 2011:

- (a) Funding proposals for the setting up of the Financial Dispute Resolution Centre and its operating expenses in the first three years;
- (b) Electricity charge subsidy; and
- (c) Consultancy study on risk-based Capital Framework for insurance business in Hong Kong.

### Lehman Brothers Minibonds

3. Mr KAM Nai-wai remarked that on 28 March 2011, 16 Lehman Brothers' Minibonds distributing banks and the Receivers made separate announcements relating to the collateral recovery agreement and final resolution of certain series of Lehman Brothers Minibonds. Mr KAM said he had written to the Chairman on 29 March 2011 requesting that the Panel should hold a special meeting before the Noteholders' meeting to vote on the collateral recovery agreement in May 2011. He suggested inviting representatives of the Hong Kong Association of Banks, the Receivers and the Trustee to explain the relevant details. Mr James TO suggested that the special meeting be held in the first half of April 2011.

4. The Chairman said that he would work out the arrangements of the special meeting with the Clerk. To facilitate discussion at the meeting, he invited Mr KAM and other members to forward to the Clerk their questions on the subject, so that the parties to be invited to the meeting could prepare relevant information for the meeting.

*(Post-meeting note: A special meeting was held on 21 April 2011 to discuss the Lehman Brothers Minibonds collateral recovery agreement and related issues.)*

### Positive credit data on mortgage loans

5. Ms Emily LAU said that the Administration should be requested to provide a paper on the up-to-date position regarding the provision of positive credit data on mortgage loans.

*(Post-meeting note: The paper on the "Latest development in relation to positive mortgage data sharing in Hong Kong" provided by the Administration was issued to members vide LC Paper No. CB(1)1975/10-11(01) on 19 April 2011.)*

### **III Regulation of Mandatory Provident Fund intermediaries**

(LC Paper No. CB(1)1748/10-11(03) — Administration's paper on "Enhanced Regulation of Mandatory Provident Fund Intermediaries"

LC Paper No. CB(1)1746/10-11 Background brief on strengthening the regulatory regime for Mandatory Provident Fund intermediaries prepared by the Legislative Council Secretariat )

#### Briefing by the Administration and Mandatory Provident Fund Schemes Authority

6. At the invitation of the Chairman, the Permanent Secretary for Financial Services and the Treasury (Financial Services) (PS(FS)) briefly introduced the subject by highlighting the preparatory work of the Mandatory Provident Fund Schemes Authority (MPFA) for implementation of the Employee Choice Arrangement (ECA), the justification for strengthening the regulation of Mandatory Provident Fund (MPF) intermediaries, and the adoption of the pre-existing institution-based approach for the proposed regulatory regime for MPF intermediaries. The details of these matters are set out in the Administration's paper LC Paper No. CB(1)1748/10-11(03).

7. The Executive Director (Regulation and Policy), Mandatory Provident Fund Schemes Authority (ED(RP)/MPFA) then gave a Powerpoint presentation on the proposed statutory regulatory regime for MPF intermediaries.

*(Post-meeting note: The notes of the Powerpoint presentation were issued to members vide a Lotus Notes email on 15 April 2011.)*

Discussion

8. Mr WONG Ting-kwong declared that he was a former non-executive director of the MPFA.

*Scope of the proposed statutory regulatory regime*

9. In reply to Mr KAM Nai-wai's enquiry, PS(FS) advised that both pre-existing MPF corporate intermediaries (CIs) and MPF individual intermediaries (IIs) sponsored by CIs would be covered by the proposed statutory regulatory regime. CIs (which would be known as Principal Intermediaries (PIs) under the legislative proposal) would be required to establish policies and measures for compliance with the legislation and designate a responsible officer to ensure that such policies and measures were properly followed, while IIs (which would be known as Sponsored Intermediaries (SIs) under the legislative proposal) would be required to comply with the conduct requirements set out in the legislation. These requirements would be further elaborated in the Code of Conduct for MPF Intermediaries issued by MPFA. Both CIs, and IIs would be liable to disciplinary actions for misconduct in carrying out MPF sales and marketing activities.

10. Mr LEE Wing-tat remarked that upon the implementation of ECA, the senior staff of MPF corporate intermediaries might set quota for the frontline staff, and due to such pressure, frontline staff would be more prone to adopt malpractices in conducting MPF sales and marketing activities. Mr LEE considered that apart from regulating frontline staff, the senior staff and owners of MPF corporations should also be held liable for malpractices in MPF sales and marketing activities. Mr LEE enquired about the sanctions applicable to such persons under the proposed regulatory regime.

11. Citing the refusal of the Securities and Futures Commission (SFC) to invoke section 107 of the Securities And Futures Ordinance (Cap. 571) to investigate mis-selling of the Lehman Brothers-related Minibonds as an example, Mr James TO Kun-sun also expressed concern that the proposed regulatory regime might not be effective in regulating the conduct of senior staff of MPF corporations in MPF sales and marketing activities.

12. In response, PS(FS) advised that the Government agreed with MPFA that it would only be prudent to legislate for the regulation of MPF sales and marketing activities before implementing the ECA to better protect MPF scheme members' interest. Under the proposed statutory regulatory regime, a PI would be required to appoint a responsible officer for maintaining proper

internal controls and procedures for compliance with the conduct requirements, and the PI would be held liable for breaches of conduct requirements if the breaches were attributable to inadequacies of the internal controls and procedures and/or supervision of their SIs. ED(RP)/MPFA supplemented that the introduction of a "PI" concept would ensure that a senior staff of an MPF corporate intermediary would be responsible for the malpractices of SI in MPF sales and marketing activities in justified cases. ED(RP)/MPFA also advised that the legislation for ECA had already specified that MPF trustees must not charge any fees for handling transfers by MPF scheme members. This would reduce the motivation of MPF intermediaries to conduct aggressive MPF sales and marketing activities.

*Justification for the proposed statutory regulatory regime*

13. Ms Emily LAU Wai-hing said that many people in Hong Kong were not satisfied with the MPF system. Referring to paragraph 7 of the Administration's paper, she enquired why MPFA anticipated that upon the implementation of the ECA, there would be a substantial increase in the number of elections by scheme members for transfer of benefits among MPF schemes. Ms LAU also enquired about the measures to afford protection to MPF scheme members and prevent the occurrence of incidents similar to the Lehman Brothers Minibonds Incident. Noting that the proposed statutory regulatory regime was modelled on the existing administrative arrangements with modifications and enhancement, Ms LAU enquired about the problems of the existing administrative arrangements, how the proposed statutory regulatory regime could tackle such problems and the number and content of relevant complaints that had been received by MPFA.

14. In response, PS(FS) advised that it was estimated that upon implementation of the ECA, up to 70% of total MPF assets would be transferable (when compared to the pre-existing 30%). This would likely result in more transfers of accrued benefits by scheme members and hence more proactive MPF sales and marketing activities.

15. As regards the existing administrative arrangements for regulation of MPF intermediaries, ED(RP)/MPFA advised that the MPF system had been implemented for 10 years and no major problems with the existing arrangements had been identified. However, with the implementation of ECA, the selling targets of intermediaries would be expanded from mainly employers to employees. In view of rising public expectation for investor protection, it was considered appropriate to strengthen the regulatory regime to ensure that it remained robust after the implementation of the ECA when the MPF sales and marketing activities would become much more active.

ED(RP)/MPFA advised that on average, only about 10 complaints were received each year against MPF intermediaries and most of them were received in the initial stage of the implementation of the MPF system.

*Regulatory approach*

16. Noting that the proposed regulatory regime would involve three frontline regulators, namely the Securities and Futures Commission (SFC), the Hong Kong Monetary Authority (HKMA) and the Insurance Authority (IA), Mr Paul CHAN enquired how the Government would ensure that these regulators would perform their regulatory role effectively and that there would be consistency in their regulatory standard and approach.

17. Ms Starry LEE also asked, as the proposed regulatory regime involved four regulatory authorities, how consistency in regulatory standard among the regulators could be ensured so that the regulation of MPF intermediaries would be fair and just.

18. PS(FS) responded that a product-based regulatory approach, i.e. designating MPFA as the sole regulator for MPF products and MPF sales activities, might not be the most desirable option as it would result in duplication of regulation and the relevant sectors might take a long time to adapt to such new regulatory arrangements. As MPF activities were incidental to the main lines of business of most MPF intermediaries, the institution-based approach would allow each financial institution to deal with a single frontline regulator for their financial activities, including MPF intermediary service. Under the proposal, MPFA would be the sole authority to issue the Code of Conduct for MPF intermediaries. It would also provide a number of "one-stop" arrangements including maintaining a MPF Intermediaries Register and receiving complaints from MPF scheme members. Frontline regulators would be empowered to inspect, investigate and discipline the MPF intermediaries under their regulatory purview. A single appeals channel would be established to handle appeals against disciplinary decisions. The Managing Director, Mandatory Provident Fund Schemes Authority (MD/MPFA) added that a forum for regular communication among MPFA and the three other regulators would be established, and this would help maintain consistency in supervision and enforcement.

19. Mr Ronny TONG expressed reservation over the Administration's proposal because he considered that there might be duplication of powers/functions between MPFA and the other regulators. Mr TONG was of the view that MPF intermediaries were already subject to the supervision of the regulator of the corresponding sector and the addition of an additional



regulator, i.e. MPFA, would be unnecessary and might affect the consistency of regulation.

20. In response, PS(FS) explained that the proposed statutory regulatory regime would provide statutory backing for the existing administrative regulatory arrangements for MPF intermediaries. This would facilitate transition and compliance by industry participants, and enable the frontline regulators to supervise the relevant MPF intermediaries more effectively.

21. Mr Ronny TONG considered that the description about the supervisory and disciplinary powers of MPFA and the frontline regulators in the Administration's paper (paragraph 12 of Annex) did not reflect what PS(FS) had just said. PS(FS) remarked that paragraph 12 of the Annex to the Administration's paper offered a general description that MPFA and frontline regulators would each be entrusted with clearly defined statutory functions. MPFA would be given powers to, for example, prescribe conduct requirements and maintain a register of MPF intermediaries, as well as to admit new participants to or remove intermediaries from the register. ED(RP)/MPFA supplemented that the powers proposed to be conferred on MPFA (i.e. the powers to issue the Code of Conduct, maintain the MPF Intermediaries Register and take certain disciplinary actions) were different from those of the three frontline regulators (i.e. the powers to conduct supervision and investigations and take disciplinary actions). Mr TONG remarked that he would not support the proposal if the Government could not provide clear explanation on why the proposed regulatory arrangements would not result in possible overlaps and a cumbersome regulatory structure.

22. Mr Paul CHAN referred to page 14 of the Administration's paper concerning the proposed particulars to be provided in the MPF Intermediaries Register and noted that the Register would contain, among others, a record of any public-related disciplinary actions taken against the MPF intermediary by MPFA/frontline regulators within a period of five years. He opined that the record should not be confined to those disciplinary actions taken by MPFA/frontline regulators. Other relevant records that were pertinent to the integrity of a MPF intermediary should also be included. He also considered that a MPF intermediary's bankruptcy/insolvency records should also be included.

23. ED(RP)/MPFA remarked that a balance had to be struck between the interests of different stakeholders. The Government and MPFA would examine whether the scope of particulars to be provided in the MPF Intermediaries Register should be expanded, taking into account Members' views.

*Implementation of Employee Choice Arrangement*

24. Ms Emily LAU, the Deputy Chairman and Mr James TO enquired about the timeframe for the legislative exercise in question and the implementation of ECA. In response, PS(FS) advised that the Administration aimed at introducing the Bill on the proposals under discussion within 2011 and hoped that the legislative process would be completed within the 2011-2012 legislative session. On that basis, it was anticipated that the ECA would be launched in the second half of 2012.

25. Mr James TO Kun-sun remarked that implementation of ECA was delayed due to the failure of the relevant authority to anticipate the potential problems with the regulation of MPF intermediaries upon the implementation of ECA. He asked whether any official(s) should be held responsible.

26. In response, MD/MPFA advised that the implementation of ECA hinged on the readiness of four prerequisite conditions, namely, the availability of a suitable electronic platform, suitable education for members of the public, sufficient training for MPF intermediaries, and proper regulation of MPF intermediaries. MPFA was carrying out the preparatory work in full steam. PS(FS) added that the implementation of ECA required the concerted efforts of all relevant parities. Based on further assessment by MPFA, the Government agreed with MPFA that it would be more prudent to introduce a statutory regulatory regime to address potential mis-selling. Hence, the Government and MPFA had spared no effort in pressing ahead with the legislative exercise. PS(FS) noted that MPFA had been preparing for the other prerequisite conditions according to schedule.

*E-platform for transfer of MPF benefits*

27. Noting that under the current proposal, a fee would be payable by the trustees to MPFA on a cost recovery basis to fund the operation of the proposed E-platform, the Deputy Chairman expressed concern that this new fee would result in an increase in the administration fee charged by MPF trustees on MPF scheme members. Mr Jeffrey LAM also enquired whether there would be any measure to prevent MPF trustees from transferring the new fee to MPF scheme members.

28. In response, MD/MPFA explained that MPF trustees currently conducted the transfer of benefits among MPF schemes through written documents. MPFA would bear the development costs for establishing the E-platform and this involved a certain amount of cost. The fee payable by

MPF trustees to fund the operation of the proposed E-platform would likely be lower than the existing cost incurred for benefit transfers through written documents, and thus the fee for the E-platform would not result in an increase in the administration fee chargeable on MPF scheme members. Besides, the E-platform would help ensure the security, accuracy and efficiency of benefit transfers among MPF schemes under the ECA.

#### *Transitional arrangements for pre-existing MPF intermediaries*

29. Mr Paul CHAN considered that the proposed transitional period of two years, during which pre-existing MPF intermediaries might conduct MPF sales and marketing activities without first securing registration under the new regime, might be too long. He was concerned that such a long grace period would be exploited by persons not eligible for registration under the new regime and thus might jeopardize the interests of MPF scheme members.

30. PS(FS) responded that if the grace period was too short, lots of applications from MPF intermediaries for registration would need to be processed within a short period, which might cause operational problems. She also clarified that the grace period was only for pre-existing MPF intermediaries to migrate to the new regime. Frontline regulators would be empowered to conduct inspection and investigations, and take disciplinary actions in respect of the MPF activities of the financial intermediaries under their purview upon commencement of the statutory regime.

#### *Risk tolerance level assessment and settlement mechanism*

31. Mr WONG Ting-kwong enquired whether, after the ECA was implemented, the assessment of the risk tolerance level of MPF scheme members by MPF intermediaries would be mandatory during the MPF sales process. He remarked that the existing requirements imposed by HKMA and SFC on their regulatees regarding the assessment of clients' risk tolerance level were complicated, and the effectiveness of such assessment was in doubt. He enquired whether a similar risk assessment scheme would be adopted under the proposed regulatory regime. Mr WONG also asked whether there would be any dispute resolution mechanism.

32. PS(FS) advised that under the proposed statutory regulatory regime, if an MPF intermediary was found to mis-sell MPF products, frontline regulators would have the power to arrange dispute resolution between the MPF intermediary and the affected MPF scheme member(s), and to enter into a settlement agreement with the MPF intermediary. Regarding the issue of risk

assessment, PS(FS) advised that the proposed statutory regulatory regime would adopt a three-tier framework:

- (a) the primary legislation would set out in broad terms the conduct requirements which MPF intermediaries should comply;
- (b) the subsidiary legislation, if any, would further prescribe the details of the conduct requirements as necessary; and
- (c) MPFA would issue non-statutory guidelines for the purpose of giving guidance to MPF intermediaries on compliance with the statutory conduct requirements.

33. PS(FS) remarked that the majority of MPF intermediaries currently conducted their main line business in banking and insurance sectors and thus they were familiar with the requirements on the assessment of their clients' risk tolerance level under the respective regulatory regimes. MPFA would draw up relevant requirements in the Code of Conduct for MPF intermediaries. ED(RP)/MPFA supplemented that any risk assessment requirement in the sales and marketing process would need to cater to the types of decisions under consideration and would have most application to the choice of MPF funds. Guidelines for the risk assessment would be compiled and the relevant stakeholders would be consulted in the process.

#### *Fees and charges on MPF scheme members*

34. Mr KAM Nai-wai remarked that some Legislative Council Members had criticized that the fees charged by MPF trustees and intermediaries were too high. Mr KAM enquired whether the fees could be reduced after implementation of the proposed statutory regulatory regime.

35. In response, PS(FS) concurred that there was room for MPF trustees to further reduce fees, and advised that MPFA had been making progress in this regard. For example, MPFA had set up a fee comparative platform to facilitate MPF scheme members to compare the fees of MPF funds, and streamlined the administrative work of MPF trustees to minimize compliance burden and hence create more room for fees reduction.

36. The Deputy Chairman said that some MPF service providers had recently introduced MPF funds with an administration fee of less than 1%. He enquired when the reduced fees would be reflected in the relevant information published by MPFA. ED(RP)/MPFA advised that MPFA would publish such information in two ways. The fee tables compiled by trustees would be updated

upon the change in fees, while the fund expense ratio would be updated and available in the MPFA's website after the end of the financial period of the MPF scheme. ED(RP)/MPFA added that the latter would take a longer time to compile. In view of the Administration's reply, the Deputy Chairman suggested that MPFA/the Administration should step up publicity to make the public aware of the availability of funds with lower administration fees.

37. The Deputy Chairman remarked that with more streamlining and automation of operational requirements and procedures, there would be more room for reduction of administration fees. He enquired whether MPFA had examined the issue with the relevant sectors. MD/MPFA responded that MPFA had maintained continued dialogue with relevant sectors on the issue of fee reduction and some progress had been made. MD/MPFA added that a number of legislative proposals aimed at streamlining the administrative procedures of the MPF system, which in parallel could facilitate MPF trustees to reduce their costs, had been introduced and passed by the Legislative Council over the years.

38. The Deputy Chairman also enquired how the Government and MPFA would assist MPF scheme members unfamiliar with investment to manage their MPF accrued benefits. MD/MPFA responded that this had to be done through education and MPFA would step up education for MPF scheme members to tie in with the implementation of the ECA. The Chairman suggested that MPFA might co-operate with the proposed Investor Education Council to avoid duplication of efforts.

39. Mr Jeffrey LAM Kin-fung opined that the existing arrangement of charging the administration fee by trustees based on a fixed percentage of the amount of accumulated assets should be reviewed. He pointed out that the provision of MPF services by trustees involved some fixed costs, and the existing fee charging basis would result in MPF scheme members with larger amounts of assets subsidizing MPF scheme members with smaller amounts of assets and was unfair to the former. As such, he suggested dividing the administration fee into two components: a fixed fee based on fixed costs and a variable fee based on the amount of assets.

40. In response, PS(FS) remarked that the Government would discuss the fees issue with MPFA. In this regard, a balance had to be struck between the enhancement of transparency and the corresponding increase in the administration costs.

*Early withdrawal of accrued benefits*

41. Ms Starry LEE Wai-king asked whether the Administration/MPFA had plans to review other arrangements of the MPF system like specifying more circumstances under which MPF scheme members might advance the withdrawal of accrued benefits. In response, MD/MPFA remarked that MPFA had commenced a review on early withdrawal of accrued benefits by MPF scheme members and would submit a proposal to the Administration in the second half of 2011.

42. Mr KAM Nai-wai suggested that the subject should be further discussed at another Panel meeting. The Chairman requested the Administration to report to the Panel on the detailed legislative proposals before introducing the relevant Bill. PS(FS) said that the Administration would keep the Panel updated.

**IV Proposed establishment of a Policyholders' Protection Fund**

(LC Paper No. CB(1)1748/10-11(04) — Administration's paper on "Proposed Establishment of a Policyholders' Protection Fund"

LC Paper No. CB(1)1711/10-11(01) — Consultation paper on "Proposed Establishment of a Policyholders' Protection Fund"

LC Paper No. CB(1)1774/10-11 — Background brief on proposed establishment of a policyholders' protection fund prepared by the Legislative Council Secretariat)

Briefing by the Administration

43. The Commissioner of Insurance (C of I) briefed members, through a powerpoint presentation, the proposals for the establishment of a Policyholders' Protection Fund (PPF), including the proposed coverage, level of compensation, funding mechanism and governance arrangements. The Deputy Secretary for Financial Services and the Treasury (Financial Services) DS(FS) remarked that a three-month public consultation exercise on the proposals had commenced on 25 March 2011.

*(Post-meeting note: The presentation notes (LC Paper No. CB(1)1870(10-11(01)) were issued to members by a Lotus Notes e-mail on 11 April 2011.)*

## Discussion

### *Initial target fund size*

44. Noting that the respective target fund size for the Life Scheme and the Non-Life Scheme was \$1.2 billion and \$75 million, to be built up in 15 years, Mr Paul CHAN enquired about the factors taken into consideration in calculating the target fund sizes and the build-up period.

45. C of I responded that the target fund sizes for the Life Scheme and Non-Life Scheme were worked out based on the industry data in 2009, the actuarial models prepared by the consultant on the basis of a large number of simulations and modelling assumptions relating to payment of compensations to insurance policyholders. The target period of 15 years was worked out based on the estimated amount of levies collected and the estimated investment return of the funds. Reference had been made to the relevant arrangements for similar policyholders' protection schemes in overseas countries. The assumptions used in the calculations were set out in the consultation paper.

46. The Deputy Chairman expressed concern that the assumption of low to medium growth rate in the insurance sector (i.e. 5 to 10% growth rate, trending to 2.5 to 5% growth rate in 10 years) was too conservative.

47. C of I responded that the assumptions for the actuarial models were worked out based on data of the general economy and the insurance industry in the past years. The assumptions and actuarial calculations would be reviewed every few years in order to review the arrangements for the PPF.

48. At the request of Mr Paul CHAN, C of I agreed to provide information on the actuarial calculations/assessments of the target fund size and the relevant assumptions.

*(Post-meeting note: The information provided by the Administration was issued to members vide LC Paper No. CB(1)2059/10-11 on 29 April 2011.)*

*Levy rate*

49. Noting that the maximum compensation limit would be set at \$1 million, and a uniform levy rate of 0.07% of the applicable premium would be applied for both the Life Scheme and Non-Life Scheme, Mr Paul CHAN was concerned that holders of insurance policies with a claim exceeding \$1 million would be required to pay a higher levy incompatible with the compensation limit of the proposed PPF. Mr CHAN enquired whether consideration would be given to adjusting the levy rate for insurance policies with different premium levels.

50. C of I responded that based on the industry data as at end 2009, the compensation limit of \$1 million would be able to meet 90 to 100% of the claims arising from some 90% of life policies, and to fully meet the claims of over 90% of non-life policies. C of I pointed out that the 0.07% levy would be collected from insurance companies based on their premium income as shown in their annual financial reports. Given the low levy rate, insurance companies probably would not transfer the levy payment to insurance policyholders.

51. Mr Paul CHAN expressed concern that based on a fixed levy rate, the PPF might follow the example of the Securities and Futures Commission which had amassed a reserve fund much higher than the target level. Ms Starry LEE shared Mr CHAN's concern and enquired whether there would be a mechanism to adjust the levy rate if the PPF had reached the target fund size for the Life Scheme and/or the Non-Life Scheme. Ms LEE also enquired whether there would be a mechanism to revise the levy rate in case there was a large pay-out as a result of the insolvency of an insurance company.

52. The Chairman remarked that the proposed PPF was essential as the insurance market was expected to expand substantially as a result of the implementation of the proposed voluntary medical protection scheme. He considered that the Administration should give more thoughts on the mechanism for adjustment to the levy rate, including the need to provide for such a mechanism in legislation.

53. C of I responded that there would be flexibility to review the levy after the target fund size had been achieved, taking into consideration the market situation at the time. C of I remarked that it would be difficult to predict the arrangement for revision of the levy in case of a large pay-out from the PPF as a result of the insolvency of an insurance company, because there were a number of unpredictable factors such as the size of the PPF at the time, the amount of pay-out and the value of the remaining assets of the insolvent



company. A review of the levy arrangement would need to be made having regard to the actual situation and prevalent market conditions at the time.

*Premature termination of insurance policy*

54. Ms Starry LEE further enquired about the arrangement for insurers who might have to transfer their insurance policies to another insurance company due to the insolvency of the original insurance company, and might suffer loss in insurance protection.

55. C of I responded that for a life policy or an accident & health policy with a guaranteed renewability clause, in the event that the insurance company went bankrupt, arrangement would be made to transfer the insurance policy to another insurance company. If the insurance policy could not be transferred and had to be terminated, the affected policyholder would be paid the cash/account value of the insurance policy plus declared dividends/bonuses, and might also be paid an "ex-gratia payment" out of the PPF to enable him/her to procure a similar policy with similar benefits in the market, up to a cap of \$1 million in total.

56. The Deputy Chairman was concerned that the cash/account value of a life policy might be very small in the initial years of the policy, and the policyholder might suffer loss and might have to pay a higher premium for a replacement insurance policy in order to secure similar terms of insurance coverage.

57. C of I responded that arrangement would be made to transfer the life policy to another insurance company, and the PPF might consider providing a payment to facilitate the transfer of such policy, and/or to grant ex-gratia payment to the policyholder if the policy could not be transferred, up to a cap of \$1 million in total.

*Governance arrangements*

58. Noting that the Financial Secretary would be empowered to appoint the Director of Audit or an external auditor to perform audit reviews on the PPF, Mr Paul CHAN opined that the Director of Audit should be empowered to carry out audit reviews of the PPF at any time, without requiring the appointment by the Financial Secretary to conduct such reviews.

59. C of I responded that the proposal was to allow flexibility for the Financial Secretary to appoint the Director of Audit or an external auditor to conduct audit reviews of the PPF as and when required, and Mr CHAN's view would be taken into consideration in finalizing the proposals.

## V Progress report on the work of the Financial Reporting Council

(LC Paper No. CB(1)1748/10-11(05) — Administration's paper on "Progress Report on the work of the Financial Reporting Council"

LC Paper No. CB(1)1775/10-11(02) — 2010 Annual Report of the Process Review Panel for the Financial Reporting Council

LC Paper No. CB(1)1747/10-11 — Background Brief on the Work of the Financial Reporting Council prepared by the Legislative Council Secretariat)

### Briefing by the Financial Reporting Council

60. The Senior Director, Investigation and Compliance, Financial Reporting Council (SD(IC)/FRC) briefed members, through a Powerpoint presentation, on the work of FRC in 2010.

*(Post-meeting note: The presentation notes (LC Paper No. CB(1)1870(10-11(02)) were issued to Members by a Lotus Notes e-mail on 11 April 2011.)*

### Risk-based review programme

61. Mr Paul CHAN expressed appreciation for the work done by FRC. He pointed out that the reported profit of some listed companies was at great variance with the profit forecast made by the companies before listing, and some companies even did not provide any profit forecast during the Initial Public Offerings. Mr CHAN enquired whether the risk-based review programme implemented by FRC since January 2011 would cover review of financial statements of listed companies with big differences between the profit forecasts and the reported profit after listing, with a view to enhancing the protection for the investing public. Mr Vincent FANG shared Mr CHAN's concern and opined that FRC should compare the profit forecasts and the reported profit of companies after listing for more than one year to identify financial statements of listed companies which required further review.

62. The Chief Executive Officer, FRC (CEO/FRC) responded that the review of financial statements of listed companies with big differences between the profit forecasts made by listed companies and the reported profit after listing could be included in the new risk-based review programme.

63. Mr Paul CHAN opined that the criteria for selection of financial statements for review under the new risk-based review programme should be made public. The Chairman, FRC responded that FRC always considered transparency important. It had published on its website its work and procedures, and where appropriate, the outcome of investigations and enquiries. FRC had also implemented the recommendation of the Process Review Panel by putting in place an assessment mechanism to determine whether an enquiry or investigation should be initiated in a particular case. FRC would consider making public the criteria for review under the risk-based review programme.

64. Mr James TO enquired whether FRC would initiate an investigation if a listed company frequently changed its asset assessor which resulted in significant changes to the value of its assets. Mr TO opined that if necessary, a review of the statutory powers and functions of FRC should be conducted.

65. The Chairman, FRC responded that if the change in valuation of the assets of a listed company was in compliance with the accounting and auditing standards, under the existing legislation, FRC would not consider initiating an investigation into the case, although FRC would pay attention to the frequent change in valuation of the assets in reviewing the financial statements of the company concerned. CEO/FRC added that under the risk-based review programme, FRC would review cases where the change in valuation of the assets of a listed company was not in line with the change in valuation on similar assets of other listed companies. The FRC's review would include a review of the assumptions for the valuations.

66. Mr Vincent FANG expressed concern that, with the increased number of listed companies, whether FRC had the required manpower to deal with any increase in workload. The Chairman, FRC responded that FRC had the required resources to handle the anticipated increase in workload. In 2010, FRC had created two additional posts to meet the manpower requirement of the new risk-based review programme and other initiatives.

#### Collaboration with other regulators

67. Mr Paul CHAN enquired whether FRC had access to the original accounting and audit documents in the Mainland during the investigation of a complaint relating to a Mainland incorporated company listed in Hong Kong

whose financial statements were audited by an approved Mainland audit firm using Mainland auditing standards.

68. Mr James TO shared Mr CHAN's concern and suggested that FRC make reference to the reciprocal investigatory arrangements of the Independent Commission Against Corruption (ICAC) for its investigation work in the Mainland. He understood that based on the Memorandum of Understanding (MOU) with the relevant Mainland authority, ICAC might send officers to the Mainland to interview witnesses and check documents, in the presence of the relevant Mainland authority.

69. The Chairman, FRC responded that so far FRC had not encountered any difficulties in investigating complaints involving local audit firms providing services to Mainland incorporated companies listed in Hong Kong. As regards the investigation of complaints relating to listed Mainland companies using approved Mainland audit firms, based on a MOU, the Ministry of Finance would work as the agent of FRC in the Mainland to investigate the cases. The Ministry of Finance and FRC would closely liaise with each other regarding the detailed requirements and arrangements for investigation of the cases. The FRC would request an investigation report from the Ministry of Finance and FRC would publish the full or part of the report as appropriate. The Chairman, FRC added that the MOU signed with the Ministry of Finance on the arrangement for investigation of complaints was in line with international practice, where the relevant regulator of the economy in which the company was incorporated would be responsible for investigation of complaints against the company and make a report to the regulator of the place where the company was listed. The Chairman, FRC remarked that FRC and ICAC were different regulatory bodies, and FRC would study ICAC's investigation arrangements in the Mainland for reference. The Chairman, FRC pointed out that the MOU with the Ministry of Finance was signed on a reciprocal basis; if FRC was allowed to investigate complaints in the Mainland, the implications of allowing Mainland authorities to investigate complaints against Hong Kong companies listed in Mainland stock markets had to be considered.

70. Mr Vincent FANG enquired, given that there would be more Mainland companies listed in Hong Kong, whether the arrangement to solely rely on the Ministry of Finance to investigate complaints relating to listed Mainland companies using Mainland auditors should be reviewed. Mr FANG expressed concern that the accounting and auditing standards used in Hong Kong and the Mainland might not be consistent, e.g. the financial reporting periods for companies listed in Hong Kong and in the Mainland were different.

71. The Chairman, FRC responded that the Ministry of Finance had shortlisted 12 approved Mainland audit firms to undertake the auditing work for Mainland companies listed in Hong Kong, and had indicated that it would continue to closely monitor the work of these audit firms. FRC would also try to arrange a meeting with the representatives of the 12 audit firms to brief them on the regulatory concerns and expectations of FRC. The Chairman, FRC further indicated that under the risk-based review programme, reviews on the financial statements of the Mainland companies listed in Hong Kong using Mainland audit firms would be conducted.

72. Given that there were overseas companies listed in Hong Kong, Mr Paul CHAN enquired whether FRC had signed MOUs with the overseas regulators concerned, similar to the arrangement with the Mainland Ministry of Finance.

73. The Chairman, FRC responded that, given that the number of overseas companies listed in Hong Kong had increased from seven companies, at the time of the Panel meeting in 2010, to 15 companies as of now, FRC would closely monitor the situation. The Chairman, FRC pointed out that so far FRC had not received any complaint relating to overseas companies listed in Hong Kong. If such a complaint was received, FRC would follow the same investigation procedures for all listed companies, and where appropriate, would seek assistance from the overseas regulator concerned. Where necessary, FRC would also seek assistance from the Stock Exchange of Hong Kong if problems were encountered in the investigation of the overseas auditors.

#### Complaint relating to Asian Citrus Holdings Limited

74. Ms Starry LEE enquired about the progress of investigation of the complaint referred to FRC by the Complaints Division of the Legislative Council Secretariat regarding Asian Citrus Holdings Limited. The Chairman, FRC stated that investigation of the case had been completed and a report had been forwarded to the Hong Kong Institute of Certified Public Accountants for follow-up action.

#### Public awareness of FRC's work

75. Ms Starry LEE expressed concern that FRC received only nine complaints in 2010. She enquired whether this was a result of the high standard of financial reporting of listed companies and accounting firms, or the lack of public awareness of the work of FRC. Mr Vincent FANG shared Ms LEE's concern.

76. The Chairman, FRC responded that the small number of complaints received by FRC reflected, to a certain extent, the high standard of financial reporting of Hong Kong listed companies and the high standard of services provided by Hong Kong's audit firms. She pointed out that a person who did not possess professional knowledge in accounting would unlikely be able to identify non-compliance with accounting requirements and lodge complaints to FRC. Most of the complaint cases came from persons associated with the companies concerned. Some of the other cases were referrals from other regulators. The Chairman, FRC said that FRC had launched a publicity programme to enhance public awareness of FRC, which included advertisements to publicize the work of FRC during popular financial programmes on radio.

## **VI Any other business**

77. There being no other business, the meeting ended at 12:48 pm.

Council Business Division 1  
Legislative Council Secretariat  
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