LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS

2013 Policy Address
Policy Initiatives of the Financial Services and the Treasury Bureau

INTRODUCTION

This information note outlines the key new and ongoing policy initiatives relating to the Financial Services and the Treasury Bureau ("FSTB").

FINANCIAL SERVICES

2. The financial markets remained turbulent in the past few years, posing serious challenges to the financial sector. The European debt crisis, global economic slowdown and excess liquidity resulting from quantitative easing measures implemented by a number of countries have heightened risk of the financial markets. Sweeping financial reforms implemented by advanced economies and international regulators in response to the institutional failures exposed by the financial crisis in 2008 have brought about far-reaching implications to the financial sector globally.

3. Despite continued uncertainty of the external environment, the financial sector in Hong Kong has demonstrated a high degree of resilience. Financial institutions remained generally stable, indicating the robustness of the regulatory framework in guarding against systemic failures. Hong Kong's status as a leading international financial centre has been recognised by various international rankings. In particular, the World Economic Forum in its Financial Development Report 2012 ranked Hong Kong first among 62 of the world's leading financial systems and capital markets for the second consecutive year, commending our large and efficient banking system, well-developed infrastructure, robust equity markets, and deep and broad commercial access to capital and financial services.

4. Yet there is no room for complacency. In the light of persistent instability in the global financial markets, we together with the regulators must stay highly vigilant and closely monitor the developments on the external front. We will act swiftly as and when necessary to ensure the proper functioning of our financial markets. At the same time, in face of the competition from other financial centres, we have been striving to strengthen the competitiveness of our financial system and proactively seizing new business opportunities arising from the shift of economic gravity from the West to the East. As set out in the

12th Five-Year Plan for the National Economic and Social Development of the People's Republic of China ("National 12th Five-Year Plan"), the Central Government has affirmed its support to Hong Kong in consolidating and enhancing our position as an international financial centre as well as developing into an offshore renminbi ("RMB") business centre and an international asset management centre. It further announced packages of measures related to the development of Hong Kong's financial market and financial institutions, particularly regarding RMB business, in August 2011 and June 2012 respectively. As China's Global Financial Centre, Hong Kong must fully leverage these opportunities to build a diversified fund-raising platform, actively contribute to the financial reform of our country, support the development of the our real economy, and promote stability of our financial system.

5. We will continue to work closely with the regulators to develop a robust financial system that is in line with international standards and provides an open, fair and orderly operating environment for market participants. We will work relentlessly to improve our market quality, with an objective to strike a reasonable balance between promoting market development and enhancing investor protection. In parallel, we will promote sustainable development of our financial sector, so as to provide quality employment for a wide spectrum of workers within the sector and related industries, enhance the competitiveness of Hong Kong's economy, and create new opportunities for both Hong Kong and the Mainland by strengthening financial cooperation.

New Initiatives

(a) *Establishment of Financial Services Development Council*

6. The Financial Services Development Council ("FSDC") will be a high-level, cross-sector advisor to the Government on ways of complementing the internationalisation of the financial market of our country and further developing the financial services industry of Hong Kong, including advising the Government on areas related to promoting the diversified development of our financial services industry and enhancing the position and functions of Hong Kong as an international financial centre of our country and in the region.

7. As pointed out by the Chief Executive, our work priorities will include the consolidation of our traditional competitive edges and the identification of new growth areas for broadening the foundation of our financial sector. For instance, we will actively enhance our offshore RMB business and asset management activities, and develop our commodity futures market. We believe the FSDC will provide us valuable advice in these areas.

8. Having studied local and overseas experiences, the FSDC will be set up as a company limited by guarantee to enhance its operational flexibility and ensure good governance. Its board of directors and functional sub-committees will include talent from the financial market and have a broad representation, ensuring that the FSDC will take into account views of various market segments.

9. In the initial stage of establishment, secretariat staff will be seconded from the FSTB and relevant authorities so that the FSDC may commence its work as soon as possible.

(b) *Over-the-counter (“OTC”) derivatives regulatory regime*

10. With the aim to implementing the Group of Twenty (“G20”) commitments on OTC derivatives regulatory reform, we have been working closely with the Securities and Futures Commission (“SFC”) and the Hong Kong Monetary Authority (“HKMA”) to develop a regulatory regime for the OTC derivatives market in Hong Kong. We expect to introduce the legislative proposals into the Legislative Council (“LegCo”) by the first half of 2013. Under the proposed regulatory regime, certain specified OTC derivatives transactions[1] will have to be reported to a local Trade Repository (“TR”) to be created by HKMA and certain specified standardised OTC derivatives transactions should be cleared through a designated central counterparty (“CCP”)[2].

---

1 In Hong Kong, interest rate swaps (“IRS”) and non-deliverable forwards (“NDF”) are the major types of OTC derivative transactions. Such transactions have major system implications to the Hong Kong market. Therefore, the mandatory reporting and clearing obligations under the proposed regime will cover certain IRS and NDF initially. We will monitor the development of the local and international market and consider the need to extend the scope to other product classes.

2 HKMA will build upon its existing Central Moneymarkets Unit (“CMU”) infrastructure to develop a local TR in Hong Kong. The CMU provides computerised clearing and settlement facilities for Exchange Fund Bills and Notes, and other Hong Kong dollar and non-Hong Kong dollar debt securities. Since December 1994, the CMU has been linked with other regional and international systems.

The Hong Kong Exchanges and Clearing Limited will establish a local CCP to provide central clearing services for OTC derivatives products.

11. Consensus on some of the important elements of the OTC derivative market reform is evolving at the international level. We will closely monitor the development of such deliberation, guidance from international standard setting bodies, as well as relevant regulations and implementation timetable in other major jurisdictions (including the US and EU), for making appropriate adjustments.

(c) *Refining the regulation of sponsors for initial public offerings*

12. Market participants were of the view that the standards of sponsor work should be enhanced. As such, SFC has conducted a public consultation in May to July last year on a number of recommendations to strengthen market confidence and to improve the overall quality of sponsors, and have published the consultation conclusions in December. SFC hopes the relevant recommendations would lay the foundation for maintaining a high-quality market and fund-raising platform, as well as encouraging sponsors to exercise care in choosing and managing listing projects, thus helping to create a quality environment for investors and those participating in initial listing offerings (including sponsors and other professionals). We will follow up with SFC on legislative amendments to clarify the responsibilities of sponsors.

(d) *Providing key legislative provisions for the establishment of an independent Insurance Authority ("IIA")*

13. We propose to establish an IIA for the better protection of insurance policyholders, greater nimbleness in responding to regulatory challenges and more effective implementation of international standards. Having completed a public consultation exercise on the proposed regulatory framework in 2010, we noted that there was general public support for the establishment of an IIA. We commenced a 3-month public consultation in October last year on the key legislative proposals. We hope to finish collecting public opinions by end January and refine the amendment bill which we aim to introduce into LegCo within this year.

(e) *Preparing for establishment of a Policyholders' Protection Fund ("PPF")*

14. To better protect insurance policyholders' interest and maintain market stability in the event of insurer insolvency, we propose to establish a PPF as a safety net for policyholders. We have announced the consultation conclusions and finalised proposals early last year. We are currently preparing the relevant legislation with a view to introducing the bill into LegCo in the 2013-14 legislative session.

(f) *Introducing legislation to support a scripless securities market*

15. We are working with the Scripless Securities Market Working Group[3] on a bill to provide the legal framework for the implementation of a scripless securities market in Hong Kong. Under the proposal, investors may choose to hold securities electronically in their own names, hence having the legal title rather than just the beneficial interest of the securities. The proposal will provide better investor choice and protection and help enhance the overall competitiveness of our securities market. SFC consulted the market on the proposed model for implementing scripless securities market in 2009 and received general support. We aim at introducing the relevant bill into LegCo within this legislative year.

(g) *Regulatory regime for electronic payment instruments and retail payment systems*

16. In view of the rapidly-advancing technologies and growing acceptance of innovative retail payment means, such as stored value facilities, internet payments and mobile payments (including interoperable Near Field Communication mobile payments and remote mobile payments), we need to enhance the legislative framework to tie in with the developments in the retail payment systems. To this end, we are researching on possible amendments to the Clearing and Settlement Systems Ordinance and the Banking Ordinance to provide for a regulatory regime for retail payment facilities and systems. The relevant work includes introducing a licensing scheme for stored value electronic money, and empowering HKMA to direct certain retail payment systems to be subject to its supervision, and to perform relevant supervisory and risk management functions.

---

[3] The Scripless Securities Market Working Group consists of representatives from SFC, the Hong Kong Exchanges and Clearing Limited and the Federation of Share Registrars.

Ongoing Initiatives

(a) *Implementing new Basel requirements*

17. Hong Kong has continued to participate constructively in the relevant international financial fora (including the Basel Committee on Banking Supervision ("Basel Committee"), Financial Stability Board and International Organization of Securities Commissions) in their deliberations on financial reforms. Hong Kong has also joined the G20 Summits as part of China's delegation. We will continue with our active participation in these international fora and consider how best to refine our regulatory regime in the light of developments in other international financial centres.

18. In December 2010, the Basel Committee put forward a set of enhanced capital requirements and new liquidity standards, which are collectively known as "Basel III", so as to enhance the resilience of the global banking system. According to the international timeline, Basel III requirements will be implemented by phases over six years between January 2013 and January 2019.

19. To this end, LegCo enacted the Banking (Amendment) Ordinance 2012 in February last year to provide for the legal framework, and completed the scrutiny of relevant subsidiary legislation in December, so that Hong Kong could implement the first phase of Basel III capital requirements starting from 1 January this year in accordance with the Basel Committee's timetable. The new capital requirements increase the level, quality and transparency of banks' capital base, as well as the risk coverage of the capital framework. The implementation of Basel III will enhance stability of the banking system and strengthen Hong Kong's position as an international financial centre. In this connection, HKMA is preparing other relevant Basel III rules under the Banking Ordinance according to the detailed requirements promulgated by the Basel Committee, including the introduction of the Banking (Disclosure) (Amendment) Rules in the next few months, and the relevant liquidity rules into LegCo for implementation in phases. In parallel, HKMA will continue to work closely with the banking industry and formulate relevant guidelines for Basel III implementation.

(b) *Investor Education Centre and the Financial Dispute Resolution Centre in full operation*

20. The cross-sectoral Investor Education Centre ("IEC") came into operation in November last year. It aims to enhance the knowledge of our investing public in financial markets and products. IEC's Executive Committee is now formulating the workplan to deliver investor education in a holistic manner. In addition, the Financial Dispute Resolution Centre ("FDRC") was established in June last year, with a view to providing an independent, accessible and efficient avenue for resolving monetary disputes between individual clients and financial institutions. Since its establishment, FDRC has endeavoured to promote mediation as a means to resolve disputes among financial institutions and investors. FDRC expects more investors would opt for mediation to resolve their financial disputes with financial institutions through enhanced promotion and publicity efforts.

(c) *Improving the Mandatory Provident Fund ("MPF") System*

21. As a retirement protection scheme, the MPF System, which has been implemented for 12 years, is still at its initial stage and requires further improvement. In this regard, we have been working together with the Mandatory Provident Fund Scheme Authority ("MPFA") to introduce a variety of measures to improve market transparency, promote market competition and enhance the arrangements of the System. One such measure is the "Employee Choice Arrangement" implemented in November last year, which provides employees greater autonomy in selecting their MPF schemes. We will closely monitor the effectiveness of this new measure in driving down MPF fees.

22. Over the past 12 years, the annualised internal rate of return (net of fees and charges) achieved under the MPF System was 3.4%, higher than the inflation rate (at an annual average of 1.3% based on the Composite Consumer Price Index) over the same period. We fully appreciate the strong community sentiments about certain arrangements of the MPF system, in particular the MPF fee level. Indeed, we consider that there is room for reduction in MPF fees. The MPF market offers over 460 fund choices for scheme members. However, such proliferation of fund choices has not served as an effective market force to drive down fees. Rather, it has negated the economies of scale that may otherwise be achieved. Further, some of the funds have a narrow focus on certain markets or industries. Whether this is consistent with the policy objective of the MPF System warrants careful consideration.

23. We and MPFA together will adopt a multi-pronged approach to improve various areas of the MPF system –

(i) Firstly, MPFA announced the results of its Consultancy Study on MPF Trustees' Administration Costs at the end of last year. MPFA has been pressing ahead with the implementation of various short and medium term measures within the existing legislative framework, so as to increase the scope of fee reduction by trustees. These proposals include : implementing industry-wide initiatives to deliver end-to-end online and electronic payments and data processing; introducing measures to facilitate scheme members' account consolidation; and facilitating industry consolidation of MPF schemes, investment funds, trustees and administration platforms, etc.;

(ii) Secondly, together with MPFA, we will consider options of enhancing its power, including the power for approving MPF schemes and funds, and their consolidations. For instance, consideration will be given to expressly including fund types, fee levels and benefits to scheme members, as factors that MPFA may take into account in processing applications for approval of MPF schemes and funds, with a view to better meeting the public needs for retirement protection. We aim to introduce the relevant legislative amendments in the 2013-14 legislative session;

(iii) Thirdly, to further increase employees' autonomy in selecting their MPF schemes, MPFA is studying the necessary supporting measures for the implementation of Full Portability, such as studies on a central database and arrangements for "one-member-two-accounts". We have invited MPFA to map out the implementation of Full Portability within three years; and

(iv) Finally, as regards the more fundamental changes, MPFA will, having regard to the objective of retirement protection, rationalise the types and numbers of MPF funds, through for instance the simplification of MPF products. We have invited MPFA to develop proposals for the implementation of a cap on MPF fees that may help address any market failure. We aim to conduct public consultation on relevant proposals within this year.

(d) *Advancing financial cooperation with the Mainland*

24. We will seize the opportunities brought by the National 12th Five-Year Plan, and advance our financial cooperation with the Mainland through the array of supportive measures announced by the Central Government in supporting Hong Kong's social and economic developments. Furthermore, by leveraging the Mainland and Hong Kong Closer Economic Partnership Arrangement ("CEPA") and other regional cooperative platforms (such as those for Guangdong-Hong Kong, Shanghai-Hong Kong, and Shenzhen-Hong Kong (including Qianhai) cooperation), we will deepen our exchanges and collaboration with the Mainland in respect of financial institutions, financial products, capital and talent for mutual benefits.

(e) *Development of offshore RMB business in Hong Kong*

25. In 2012, Hong Kong made significant progress in the development of offshore RMB business, including both trade settlement volume and financing business through bond issuance. RMB investment products have also become more diversified, covering RMB-denominated A-share Exchange-traded Funds ("ETFs"), life insurance policies and real estate investment trust, RMB currency futures, gold ETF, etc. The first "dual tranche, dual counter" shares traded in both RMB and Hong Kong dollar started trading on the stock exchange October last year. The Central Government has also introduced a series of measures to support the development of offshore RMB business in Hong Kong. For example, the RMB Qualified Foreign Institutional Investors quota has been increased from the original RMB20 billion to RMB270 billion, expanding the scope of development for offshore RMB investment products. The Central Government has also announced that the issuance of RMB sovereign bonds in Hong Kong by the Ministry of Finance would be a long-term institutional arrangement and that the scale of issuance will be gradually expanded, while it would continue to allow Mainland banks and non-finance-related enterprises to issue RMB-denominated bonds in Hong Kong. These measures not only underscore the important role played by Hong Kong in promoting the cross-border use of RMB, but they also help consolidate Hong Kong's status as a global centre for offshore RMB trade settlement, financing and asset management. With the development of offshore RMB business, financial intermediary activities in Hong Kong have become more vibrant, and the industry has been making use of the vast RMB liquidity pool to develop a wide range of financial products. These have facilitated the cross-border flows and healthy circulation of RMB funds, allowing the RMB market to enhance its price discovery function and demand-supply balance. We will continue to work closely with the relevant Mainland authorities, local regulators and market

players for the active promotion of the wider use of RMB outside Mainland China. We will keep enhancing our market infrastructure and strengthening our financial platform for the further growth of Hong Kong's offshore RMB business in a risk-controlled environment with a view to developing Hong Kong into a global offshore RMB business hub. At the same time, as the Mainland commodity futures market is gradually moving in pace with the international market, we will endeavour to ensure Hong Kong will play a part in this internationalisation process.

(f) *Strengthening Hong Kong's role as a fund-raising centre*

26. As a premier fund-raising centre for Mainland and overseas corporations, Hong Kong has its competition edge on various fronts. We must continue to enhance the regulatory framework, with the view to striking a reasonable balance between market development and investor protection. At the end of last year, 25 jurisdictions had been accepted in principle as jurisdictions of incorporation for overseas companies seeking a listing on the Stock Exchange of Hong Kong ("SEHK"). We continued to attract companies from new overseas jurisdictions to list in Hong Kong last year, including Sunshine Oilsands Limited from Canada and Dynam Japan Holdings Company Limited from Japan.

27. SEHK has developed, and will update where necessary, vetting practices to facilitate initial public offerings by overseas companies. Such practices include publishing newly accepted overseas jurisdictions on the SEHK website; allowing subsequent issuers from jurisdictions which have already been considered and accepted to follow a simpler process; allowing a potential issuer to show that its shareholder protection standards are comparable to the standards of any one of the recognised or accepted jurisdictions; and adopting a purposive interpretation of the requirements for "equivalence" to Hong Kong corporate regulation standards and so on.

28. Full implementation of the statutory disclosure regime for price sensitive information of listed corporations : Following the enactment of the Securities and Futures (Amendment) Ordinance 2012 in May last year, the statutory regime for disclosure of inside information has come into operation on 1 January this year. Listed corporations are required to disclose price sensitive information to the public in a timely manner. The regime will bring our regulatory regime for listed corporations more in line with other international financial centres and enhance Hong Kong's strength as a premier capital formation platform.

29. To facilitate compliance, SFC has launched a consultation service with a view to assisting listed corporations in understanding and complying with the statutory disclosure provisions since December last year. SFC has been giving presentations for professional organisations and trade bodies. SFC and the Hong Kong Exchanges and Clearing Limited have also organised several seminars in Hong Kong, Shanghai and Beijing. The seminars were well received with an attendance of over 1 700.

30. Implementing the new Companies Ordinance : We expect the new Companies Ordinance to commence operation in the first quarter of 2014. Prior to that, we will enact the relevant subsidiary legislation to set out the procedural, administrative and technical matters required for the implementation of the new Ordinance. In this regard, a public consultation exercise on the subsidiary legislation was conducted in two phases between September and December last year. We are finalising the subsidiary legislation for introduction into LegCo by batches starting from the first quarter of 2013.

(g) Promoting asset management business

31. Hong Kong has developed itself into a premier asset management hub in Asia. At end 2011, the combined fund management business of Hong Kong reached $9,038 billion, representing an increase of 54.5% as compared with three years ago. 63.3% of the funds managed in Hong Kong were sourced from non-Hong Kong investors, showing that Hong Kong is a preferred location for overseas fund managers to conduct asset management business. Moreover, the National 12th Five-year Plan affirmed the Central Government’s support for Hong Kong to develop as an international asset management centre.

32. We adopt multi-pronged measures to develop Hong Kong as an asset management centre to enhance the competitiveness of Hong Kong’s asset management industry. These include establishing a network of comprehensive agreements for the avoidance of double taxation with major trading and investment partners; refining the Trust Law; developing a platform for Islamic finance; fostering the developing of the offshore RMB business; and stepping up overseas promotion.

33. Trust law reform : We are reforming the trust law in Hong Kong to bolster the competitiveness of Hong Kong’s trust services industry and attract settlors to set up trusts in Hong Kong, thereby enhancing Hong Kong’s status as an international asset management centre. We aim to introduce the relevant bill into LegCo in the first quarter of 2013.

34. Islamic bonds : We will continue to enhance our market infrastructure, encourage product development, foster collaboration with other Islamic finance centres, and raise the profile of Hong Kong as an Islamic finance platform. We have recently introduced the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Bill 2012 into LegCo to provide a comparable taxation framework for common types of Islamic bonds (i.e. sukuk) vis-à-vis conventional bonds. We will work with Members in their scrutiny of the bill.

35. Developing the local bond market : We will continue with our efforts to promote the development of the local bond market, including ongoing implementation of the Government Bond Programme. We will engage major market players to better meet evolving market needs.

36. To further enhance the competitiveness of Hong Kong's asset management industry, we are working closely with the industry and the relevant regulators to explore feasible arrangements to refine our regulatory regime and taxation arrangements, in order to promote sustainable development of Hong Kong's asset management industry and remove hindrance to market development.

(h) Improving the corporate insolvency laws

37. To keep up with international developments and standards, we have rolled out an exercise to improve the corporate insolvency laws. The exercise aims at streamlining and rationalising company winding-up procedures having regard to international experience, with a view to facilitating more efficient administration of winding-up and enhancing protection of creditors. We plan to launch a public consultation in 2013, and expect to introduce the relevant bill into LegCo within the current legislative term. We also seek to take this opportunity to consolidate past experience and seek consensus to provide for a new statutory corporate rescue procedure, which aims at providing companies in short-term financial trouble with an opportunity to turn around or re-structure business.

THE TREASURY

38. The Treasury Branch will continue to pursue the following -

(i) in line with the Basic Law requirement, ensure that expenditure is kept within the limits of revenue in drawing up the budget, strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of Gross Domestic Product;

(ii) review the legislative framework on tax matters to enable Hong Kong to remain a highly competitive economy and one of the freest in the world while preserving our simple low tax regime; and

(iii) consider options to broaden revenue streams for the Government so that expenditure items can be funded.

(a) *Tax Information Exchange Arrangement*

39. We are committed to expanding Hong Kong's network of comprehensive avoidance of double taxation agreements ("CDTAs") with our trading and investment partners to provide certainty on taxation of cross-border activities and relief for double taxation. This is a key to facilitating the flow of trade, investment and talent between Hong Kong and the rest of the world, as well as enhancing Hong Kong's position as an international business and financial centre. We reckon the international trend of enhancing tax transparency and will continue to ensure that Hong Kong's tax information exchange arrangement is on par with the international standard, so as to preserve Hong Kong's international reputation as a co-operative jurisdiction while ensuring that interests and concerns of relevant stakeholders are well taken care of.

40. In November 2012, we briefed the LegCo Panel on Financial Affairs on the progress of our CDTA negotiations and the latest international trend with regard to exchange of tax information. We will consult the Panel in February 2013 on our detailed legislative proposals in relation to tax information exchange arrangements, which seek to enhance the existing arrangements to meet the international standards such that Hong Kong could further expand the CDTA network whilst putting in place a legal framework for entering into Tax Information Exchange Agreements with other jurisdictions where necessary. Our plan is to introduce into the Legislative Council relevant amendments to the Inland Revenue Ordinance (Cap. 112) by late April 2013.

(b) *Relocation of government offices outside core business districts*

41. Our policy has been to relocate government departments with no location requirements to remain in core business districts to lower-value areas. For example, the relocation of Independent Commission Against Corruption to North Point in 2007 has freed up a prime site at Murray Road. Subject to rezoning and completion of the required technical assessment, the site can be developed into some 40 000 square metres of Grade A office space. The completion of the Trade and Industry Tower in Kai Tak in end 2014 will release 18 000 square metres of floor area in the Trade and Industry Department Tower in Mongkok for commercial uses. Meanwhile, we are taking active actions to relocate departments in the three government office buildings at the Wan Chai waterfront. We shall also continue to reduce our leased office space in Central and Admiralty. The total gross floor area of office premises leased by the Government in both districts has reduced from 11 500 square metres six years ago to the present 2 760 square metres, and is expected to further reduce to 230 square metres in 2015.

Financial Services and the Treasury Bureau
16 January 2013