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Panel on Financial Affairs

Meeting on 7 April 2014

**Background brief on the Government's latest initiatives
to develop the asset management industry**

Purpose

This paper provides background information on the Government's latest initiatives to develop the asset management industry in Hong Kong, and summarizes the concerns and views expressed by Members during relevant discussions at meetings of the Legislative Council and its committees in 2013 and 2014.

Background

2. The "Outline of the Twelfth Five-Year Plan for the National Economic and Social Development of the People's Republic of China" promulgated in March 2011 contained a dedicated chapter on Hong Kong and Macao. In respect for Hong Kong, the chapter emphasized the Central Authorities' support for consolidating and enhancing Hong Kong's competitive advantages, including amongst others, its development into an international asset management centre.

3. In the 2010-11, 2011-12 and 2012-13 Budget Speeches, the Financial Secretary ("FS") has indicated Government's proposed measures to promote Hong Kong's asset management industry, including introducing stamp duty concession for the trading of exchange traded funds, profits tax concession for certain debt instruments, a level playing field for common types of Islamic bonds vis-à-vis their conventional counterparts in terms of profits tax, property tax and stamp duty, and developing the local bond market etc.

These measures have been put into implementation. FS further indicated in his 2013-14 Budget Speech the following two initiatives to further develop the fund and asset management business of Hong Kong and its plan to conduct consultation on the initiatives:

- (a) to extend the profits tax exemption for offshore funds to include transactions in private companies which are incorporated or registered outside Hong Kong and do not hold any Hong Kong properties nor carry out any business in Hong Kong, so as to attract more private equity ("PE") funds to domicile in Hong Kong; and
- (b) to consider legislative amendments to introduce the Open-ended Investment Company ("OEIC") which is an increasingly popular form used in the fund industry, so as to attract more traditional mutual funds and hedge funds to domicile in Hong Kong.

4. On 18 November 2013, the Financial Services Development Council ("FSDC") released six research reports which aimed to strengthen Hong Kong's position as the preeminent international financial centre and enhance the development of the local financial services industry. Two of the research reports, namely "Synopsis Paper Proposing Tax Exemptions and Anti-avoidance Measures on Private Equity Funds in the 2013-14 Budget" and "Proposals on Legal and Regulatory Framework for Open-ended Investment Companies in Hong Kong", are related to the initiatives on PE funds and OEIC included in the 2013-14 Budget. FSDC's research reports recommended the operation of an OEIC regime in Hong Kong and the extension of profits tax exemptions to offshore PE funds. The relevant research reports are given in the hyperlinks in the **Appendix**.

Discussions by Members on related issues

Panel on Financial Affairs

5. The Panel on Financial Affairs ("FA Panel") was briefed on the work of FSDC at the meeting on 6 January 2014. During the discussion, some members enquired about the details and implementation timetables on FSDC's recommendations regarding the proposals on PE funds and OEIC, and the legislative amendments to implement the two proposals. The Administration advised that its plan was to conduct public consultation on the OEIC proposal in the first quarter of 2014, and to consult FA Panel on the proposed tax exemptions and anti-avoidance measures on PE funds in the same quarter after further consultation with the industry. In respect of the

OEIC proposal, the Administration and the Securities and Futures Commission were still considering the legislative approach for regulation of OEICs. As regards the proposal on PE, it would involve amendments to section 16 of the Inland Revenue Ordinance (Cap. 112). Subject to the outcome of consultation, the profits tax exemptions in question for offshore PE funds would be applicable to income generated from limited liability partnership, and ownership of properties or operation of business in Hong Kong.

6. In response to members' enquiries about whether FSDC had taken into account Hong Kong's simple tax regime, the principle of territorial basis of taxation adopted by Hong Kong, as well as consulted the Treasury Branch of the Financial Services and the Treasury Bureau ("FSTB") before putting forward the recommendations in the research reports, FSDC pointed out that the recommendations had taken into account the industry's views about inadequate tax incentives to attract PE funds to Hong Kong and tax issues which warranted clarification by the Inland Revenue Department ("IRD"). FSDC had exchanged views with IRD and the Treasury Branch of FSTB on its recommendations. The Administration supplemented that it would consider FSDC's tax proposals carefully having regard to their potential impact on Hong Kong's taxation regime and benefits to the local financial services industry. Moreover, the Administration would consult the Panel on the proposals where appropriate.

Special meetings of the Finance Committee to examine the Estimates of Expenditure 2013-14

7. In connection with the examination of the Estimates of Expenditure 2013-14 during special meetings of the Finance Committee, Members raised a number of written questions relating to Government's proposed initiatives to further develop Hong Kong's fund and asset management business. Such questions covered the details and timetable of the initiatives and the Administration's assessment of possible risks associated with such initiatives. In its replies, the Administration highlighted the proposed initiatives and advised that it would conduct consultation on the relevant proposals. The Administration also stressed that it attached great importance to financial safety and would review the regulatory regime from time to time. Measures would be introduced as necessary to maintain the stability of Hong Kong's financial system and improve the quality of the market. Details of the written questions and the Administration's replies are given in the hyperlink in the **Appendix**.

Council meetings

8. At the Council meeting on 3 July 2013, Hon Christopher CHEUNG raised a written question on the development of Hong Kong as an international asset management centre, including details of the initiatives in this regard. The Administration advised that it was adopting multi-pronged strategies to consolidate Hong Kong's leading role as the asset management centre in the Asia-Pacific region, and to develop Hong Kong into a more comprehensive fund and asset management centre. To this end, the Administration planned to introduce OEIC into Hong Kong for setting up investment funds and to extend the profits tax exemption for offshore funds to include transactions in private companies which were incorporated or registered outside Hong Kong and did not hold any Hong Kong properties nor carried out any business in Hong Kong.

Latest Development

9. The Administration launched a three-month public consultation on the OEIC proposal on 20 March 2014. The Administration will brief FA Panel on the proposal at the meeting on 7 April 2014.

Relevant papers

10. A list of relevant papers is in the **Appendix**.

Appendix

List of relevant papers

Date	Event	Paper/Minutes of meeting
8 to 12 April 2013	The Finance Committee held special meetings to examine the Estimates of Expenditure 2013-14	Administration's replies to Members initial written questions for the session on "Public Finance"
3 July 2013	Hon Christopher CHEUNG raised a written question regarding the development of Hong Kong as an international asset management centre	Hansard
18 November 2013	The Financial Services Development Council released the first batch of six research reports	Press release Research reports
6 January 2014	The Panel on Financial Affairs was briefed by the Financial Services Development Council on its work	Discussion paper (LC Paper No. CB(1)625/13-14(03)) Letter from Hon Dennis KWOK dated 11 December 2013 (LC Paper No. CB(1)625/13-14(04))
20 March 2014	The Administration launched a public consultation on introducing a new open-ended fund company structure	Press release Consultation paper