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LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS

2015 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 services industry is an important pillar of the Hong Kong economy, contributing to one-sixth of our Gross Domestic Product and providing 240,000 jobs which account for 6% of the working population. Hong Kong's position as the world's financial centre is also widely recognised. The International Monetary Fund Financial Sector Assessment Programme report released in May last year acknowledged that Hong Kong's financial sector was one of the largest and most developed in the world. The report also commended the resilience of Hong Kong's financial system as well as its intensity of supervision, comprehensiveness of risk assessment, and the active use of macroprudential policies.

3. Hong Kong is the world's largest offshore Renminbi ("RMB") business hub and also Asia's leading fund raising and asset management centre. As at end November 2014, RMB deposits and outstanding RMB certificates of deposit exceeded RMB1.1 trillion. As at end 2013, the asset under management of the fund management business in Hong Kong achieved a record high of HK$16 trillion, representing a year-on-year growth of 27% from 2012.

4. While the US economy is steadily improving and the normalisation of its monetary environment is in progress, Europe and Japan are loosening their monetary policy in light of weak economic growth. This divergence further heightens the complexity in the global macroeconomic and monetary backdrop. Meanwhile, Russian Ruble's sharp depreciation late last year due to slump in oil prices and Western sanctions, together with an early election of Greece in January 2015, added uncertainty to the global financial market. Although the financial services sector in Hong Kong demonstrated a high degree of resilience during the past few years notwithstanding the uncertain external environment, there is no room for complacency. Together with regulators, we are closely monitoring the latest development of the global and local financial markets, and will act swiftly as and when necessary to ensure the proper functioning of our financial markets.

5. Various financial reforms rolled out by international regulatory organisations over the past few years are already being implemented. We will, together with regulators, closely follow the latest development of the international financial reform agenda and keep our regulatory framework up-to-

date and on a par with international standards to enhance the stability of our financial system.

6. We also attach importance to market and infrastructural development in maintaining the competitiveness of Hong Kong as a financial centre. Sustained development of the financial services industry can provide employment opportunities to a broad spectrum of the labour market as well. We are thus working to strengthen Hong Kong’s position as a leading financial centre in the region and reinforce our roles as an offshore RMB business centre, an international asset management hub and a premier global platform for capital formation. We will deepen our financial cooperation with the Mainland for mutual benefits and seek greater market access for local financial services, while providing a platform for Mainland capital and enterprises to “go global”. We will continue to collaborate with the industry in capturing Hong Kong’s advantages in financial and professional services and encouraging the development of new businesses to nurture a more diversified financial market in Hong Kong.

New Initiatives

(a) *Risk-based capital regime*

7. We are formulating a risk-based capital regime for insurance companies to align Hong Kong’s regulatory regime with international standards and make capital requirements more sensitive to the level of risk borne by

insurance companies. We completed the three-month consultation on the proposed framework in December last year. We will conduct another round of consultation on the detailed rules after carrying out a related quantitative impact study this year.

(b) *<u>Review of abscondee regime under the Bankruptcy Ordinance (“BO”) (Cap.6)</u>*

8. The BO currently provides that where a bankrupt has left Hong Kong under certain circumstances, the bankruptcy period[1] will automatically be suspended from running until the bankrupt has returned to Hong Kong and notified the trustee-in-bankruptcy (“TIB”) of his return. This is commonly known as the abscondee regime. Following the ruling of the Court of Final Appeal in 2006 that the restraint imposed by one of the provisions (section 30A(10)(b)(i)) on a bankrupt’s right to travel was more than necessary for the protection of the rights of creditors, the Government has conducted a review of the abscondee regime and briefed the Legislative Council (“LegCo”) Panel on Financial Affairs (“FA Panel”) the review outcomes and proposed legislative amendments in May last year. Having engaged stakeholders for their views between May and July last year, we have finalised detailed legislative proposals for amending the BO to replace the existing regime. In view of the importance of an initial interview between a bankrupt and the TIB to case administration, the

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[1] The BO provides that a bankrupt will be automatically discharged from bankruptcy upon the expiry of the bankruptcy period. The bankruptcy period is four years for first-time bankrupts and five years for repeat bankrupts.

proposed regime will provide that if a bankrupt does not attend or fails to complete such an interview, the court may on application of a TIB exercise discretion to deem the bankruptcy period of the bankrupt concerned as not having commenced running. We are drafting the relevant bill and aim to introduce it into LegCo within the current legislative session.

Ongoing Initiatives

Promoting Market Development

(a) *Further advancing financial cooperation with the Mainland and offshore RMB business*

9. We will strengthen our position as an international financial centre by capitalising on the unique role of Hong Kong in our country's continuous financial reform and opening-up, and taking full advantage arising from the Shanghai-Hong Kong Stock Connect ("Stock Connect") and Hong Kong's position as the global offshore RMB hub. We will also leverage on the Mainland and Hong Kong Closer Economic Partnership Arrangement and other regional cooperative platforms (such as those for Guangdong-Hong Kong, Shanghai-Hong Kong, and Shenzhen-Hong Kong (including Qianhai) cooperation) to strengthen our exchanges and collaboration with the Mainland in respect of financial institutions, financial products, capital and talent for mutual benefits.

10. Stock Connect was officially launched in November last year, connecting the Hong Kong and Shanghai securities markets and allowing individual and institutional investors of both places to participate in cross-border trade in each other's market directly. Stock Connect is a mutually beneficial collaboration project. Through enhancing mutual stock market access between Hong Kong and Shanghai, the programme augments the gradual opening up of the Mainland's capital accounts as well as the internationalisation of RMB. It will also reinforce Hong Kong's position as a premier international financial centre and strengthen Hong Kong's role as an offshore RMB business centre. In the same month, the RMB conversion limit for Hong Kong residents of RMB20,000 per day was removed, facilitating Hong Kong residents to participate in Stock Connect and other RMB-denominated financial transactions. This is conducive to the launch and sales of RMB investment products by financial institutions in Hong Kong.

11. We will continue to maintain close communication with relevant Mainland authorities to deepen the mutual access between Hong Kong and Mainland financial markets, enhance our RMB business links with overseas markets by strengthening our market infrastructure and financial platforms, and organise seminars and roadshows overseas to promote Hong Kong's offshore RMB business.

(b) *<u>Consolidating Hong Kong's position as the premier asset management centre in Asia-Pacific</u>*

12. Under the rapid economic growth and wealth creation in Asia, together with continued financial market liberalisation in the Mainland, we have the advantage to attract more funds of various types to base and operate business in Hong Kong to broaden the variety and scope of our fund business as well as facilitate portfolio allocation by investors. To this end, the Government and regulators have been implementing various policy initiatives to remove existing restrictions in the legal structure, broaden the product base and provide a more facilitating tax environment to sharpen Hong Kong's competitive edge as a premier international asset management centre.

(i) <u>Broadening the legal infrastructure</u>

13. To diversify our fund management platform, we are taking steps to introduce a new open-ended fund company ("OFC") structure to expand Hong Kong's legal structure for investment fund vehicles. The OFC proposal will allow funds to be set up in an open-ended structure like a company, but with the flexibility not enjoyed by conventional companies to create and cancel shares for investors to trade the funds. The proposal will attract more funds to domicile in Hong Kong, which will help build up Hong Kong's fund manufacturing capabilities to complement the existing fund distribution network and develop Hong Kong into a full fund service centre from product design to marketing and distribution. We are now formulating the detailed legislative proposals by

taking into account the comments received during the three-month public consultation last year.

(ii) Creating a conducive tax environment

14. We are working on the legislative amendments to the Inland Revenue Ordinance to extend the profits tax exemption for offshore funds to include transactions in private companies which are incorporated outside Hong Kong. This will allow offshore private equity funds to enjoy the same exemption as those currently available to other offshore funds. We hope to attract more private equity fund managers to hire local asset management, investment and advisory services, which will be conducive to further development of our asset management industry and drive demand for other relevant professional services, such as business consulting, tax, accounting and legal services. We consulted the FA Panel on the legislative proposals in January 2015, and aim to introduce the relevant bill into LegCo in the first half of 2015.

(iii) Stamp duty for transfer of exchange traded funds ("ETFs")

15. The Government has proposed in last year's Budget to waive the stamp duty for the transfer of all ETFs to help promote the development, management and trading of ETFs in Hong Kong. We introduced the relevant Stamp Duty (Amendment) Bill 2014 into LegCo in December last year. We are arranging the resumption of the Second Reading debate on the bill. The waiver

will take effect on the day on which the relevant ordinance is published in the Gazette after its enactment by LegCo.

(iv) <u>Attracting corporations to manage treasury activities in Hong Kong</u>

16. Hong Kong has a well-developed financial infrastructure, a simple tax system, and a large pool of financial talents. If multi-national and Mainland corporations could centralise their regional high value-added treasury functions in Hong Kong, including handling capital investment and financing activities within the group, centralising payment services within the group, and centralising exchange and interest rate risk management, it would bring more employment and opportunities to other financial and professional services sectors. As such, we are studying different proposals to attract corporations to set up corporate treasury centres in Hong Kong.

(c) *<u>Developing the local bond market</u>*

17. To promote the development of the local bond market and Islamic finance, we issued the first Islamic bond (i.e. sukuk) with a total size of US$1 billion under the Government Bond Programme last year. We shall continue soliciting views from the market participants to ensure that measures to boost local bond market could meet the market needs.

(d) *Financial Services Development Council ("FSDC")*

18. The FSDC, established by the Government in 2013, has published 12 reports so far. The reports provided a collection of concrete proposals on subjects including offshore RMB business, Mainland-related opportunities, the fund raising platform, asset management, promotion and human capital. The Government will continue to provide support for the work of the FSDC as a high-level cross-sectoral Government advisory body in collecting views from the industry to formulate strategic proposals for the development of our financial services industry and advise the Government on industry development.

Enhancing Market Quality and Investor Confidence

(a) *Establishment of an independent Insurance Authority ("IIA")*

19. For the establishment of IIA, we introduced in April last year the Insurance Companies (Amendment) Bill into LegCo which is now scrutinising the bill. The regulatory reform aims to align Hong Kong's regulatory regime with international practices, facilitate the stable development of the insurance industry and provide better protection for policyholders. We strive to have the bill enacted in mid 2015 and will prepare for the establishment of the IIA thereafter. We will continue to discuss transitional issues with the industry through the Working Group on Transition to the Independent Insurance Authority.

(b) *Preparing for establishment of a Policyholders' Protection Fund*

20. To better protect insurance policyholders' interest and maintain market stability in the event of insurer insolvency, we propose to establish a Policyholders' Protection Fund as a safety net for policyholders. We are preparing the detailed legislative proposals.

(c) *Improving the corporate insolvency laws and introducing a statutory corporate rescue procedure*

21. We have commenced an exercise to improve the corporate insolvency laws to streamline and rationalise the company winding-up procedures and enhance regulation of the winding-up process having regard to international experience. The underlying objectives of the exercise are to facilitate more effective administration of the winding-up process and increase protection of creditors. We conducted a public consultation on the legislative proposals in 2013 and issued the consultation conclusions in May last year. On the basis of the respondents' support for the legislative exercise, we are now preparing the relevant legislation and aim to introduce an amendment bill into LegCo in the current legislative session.

22. In this connection, we have announced a package of legislative proposals in respect of the introduction of a statutory corporate rescue procedure and insolvent trading provisions last year. In view of the support of the FA Panel and other stakeholders for the legislative exercise, we plan to further

discuss with stakeholders this year on the detailed proposals to pave the way for drafting the legislation in the future.

Implementing International Standards and Enhancing the Regulatory Regime

(a) *Regulatory regime for the over-the-counter ("OTC") derivative market*

23. The Securities and Futures (Amendment) Ordinance 2014, enacted by LegCo March last year, provides for a regulatory framework for the OTC derivative market in Hong Kong to meet the relevant G20 commitments. The framework enables the mandatory reporting, clearing and trading of OTC derivative transactions, and introduces a record keeping obligation to supplement the implementation of the abovementioned obligations. The precise ambit of these obligations, and their related details, in phases will be set out in subsidiary legislation (i.e. rules) to be made by the Securities and Futures Commission ("SFC") with the Hong Kong Monetary Authority ("HKMA")'s consent and after consultation with the Financial Secretary. We aim to table the first batch of subsidiary legislation before LegCo for negative vetting in the first quarter of 2015 for the implementation of the mandatory reporting and related record keeping obligations.

24. In addition, HKMA has established a trade repository, and implemented interim reporting requirements on banks since August 2013. OTC Clearing Hong Kong Limited, established locally by the Hong Kong Exchanges

and Clearing Limited ("HKEx"), has also started to provide voluntary clearing services since November 2013.

(b) *<u>Development of an effective cross-sectoral resolution regime for financial institutions</u>*

25. FSTB, together with HKMA, SFC and Office of the Commissioner of Insurance, conducted the first stage of public consultation during January to April last year in order to gather views from the public and the financial services sectors on how to bridge the gaps which exist in our current resolution regimes for different types of financial institutions relative to the Key Attributes of Effective Resolution Regimes for Financial Institutions, promulgated by the Financial Stability Board in November 2011. By the close of the consultation, we received over 30 submissions from the industry and the public, and met with a number of trade bodies, professional associations and LegCo Members to listen to their views. The public and stakeholders were broadly supportive of the development of a resolution regime for different types of financial institutions in Hong Kong.

26. We will launch the second stage of public consultation in January 2015. We plan to roll out the third stage of public consultation in the first half of 2015 concerning some issues which are still being developed and deliberated at the international level, with a view to introducing legislative proposals into LegCo by end of 2015.

(c) *Implementing new Basel requirements*

27. Hong Kong has made the rules under the Banking Ordinance for the implementation of the second phase of Basel III requirements in accordance with the timetable recommended by the Basel Committee on Banking Supervision. The new liquidity standards and capital buffers requirements have come into operation on 1 January 2015 and the corresponding disclosure requirements are being implemented. We are preparing amendments, related to the outcome of the Basel Committee Regulatory Consistency Assessment Programme, to the Banking (Capital) Rules, with a view to introducing the subsidiary legislation into LegCo within this year. In parallel, HKMA will continue to work closely with the banking industry and formulate relevant guidelines for Basel III implementation to facilitate compliance.

(d) *Countering money laundering and terrorist financing*

28. We will actively pursue measures to combat money laundering, improve risk assessment, and participate actively in the Financial Action Task Force.

(e) *Auditor regulatory reform*

29. Auditors play the role as a key gatekeeper in assuring the integrity and accuracy of the financial reports of listed companies. In view of international trend that the oversight of the regulation of auditors is to be

independent of the profession itself, the Government has been discussing with the Financial Reporting Council and the Hong Kong Institute of Certified Public Accountants ways to enhance the independence of our regulatory regime with a view to ensuring that the regime is benchmarked against international standards. We put forward a package of proposals on improving the regulatory regime for listed entity auditors for three months' public consultation in June last year. We are studying all the submissions carefully as we prepare the detailed legislative proposals.

Enhancing Financial Infrastructure

(a) Uncertificated securities market regime

30. In June last year, we introduced the Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014 into LegCo to provide for a legal framework to enable the introduction of an uncertificated securities market regime. Under the proposed regime, investors can hold and transfer legal ownership in securities without paper documents. This measure will help enhance the overall efficiency of our securities market, strengthen corporate governance, secure an improved level of investor protection, facilitate market development and ensure that Hong Kong is on a par with other leading markets. In addition, a working group comprising SFC, HKEx and the Federation of Share Registrars has been actively working out the operational details of the uncertificated securities market.

(b) *Regulating stored value facilities and retail payment systems*

31. Payment products and systems are closely related to the stability of a financial system. A sound regulatory environment does not only improve users' acceptance and confidence in these products and services, but is also conducive to the further development of retail payment products and services in Hong Kong. We plan to introduce the relevant amendment bill to LegCo in early 2015 to empower HKMA to regulate stored value facilities and retail payment systems.

Enhancing the Mandatory Provident Fund ("MPF") System

32. To enhance the MPF System as one of the pillars for providing retirement protection for the working population, we and the Mandatory Provident Fund Schemes Authority ("MPFA") continued to implement a variety of measures to improve market transparency, promote market competition and enhance arrangements under the system last year. There were already some achievements : management fees of 181 funds were reduced last year, with the largest reduction being 118 basis points. In addition, upon MPFA's request for trustees to offer at least one "low-fee fund" that invests in equities and/or bonds (i.e. funds with management fee not higher than 1.0% or fund expense ratio of 1.3% or below) in each scheme, as at the end of last year, there were 173 "low-fee funds" under 38 schemes.

33. We introduced into LegCo in July last year the MPF Schemes (Amendment) Bill 2014, which aims to provide more flexible arrangements for

scheme members to withdraw their accrued benefits, simplify regulatory procedures to drive down MPF fees and facilitate MPFA in performing its functions more effectively. The Bills Committee has completed the scrutiny of the bill in December last year. We hope to secure early passage of the bill.

34. To further facilitate scheme members in making MPF investment that fulfills the long term retirement savings objective and drive down MPF fees, we consulted the public on introducing “Core Fund” as an MPF default fund from June to September last year. The majority of the responses received supported the proposal, including establishing a fee control mechanism for such fund. Our target is to introduce legislative amendment proposals to LegCo in the coming legislative session to allow early introduction of “Core Fund”.

THE TREASURY

Tax Information Exchange Arrangements

35. We will, as an on-going initiative, continue to update our tax information exchange regime to meet international standard for enhancing tax transparency and preventing fiscal evasion. In this connection,

(a) We are committed to expanding Hong Kong’s network of comprehensive agreements for avoidance of double taxation (“CDTAs”) with our major trading and investment partners as well as emerging economies with which we see potential for growth in bilateral trade and investment. Up to mid-January 2015, Hong Kong has signed 32 CDTAs. Fifteen of these CDTAs (i.e. nearly half) were signed over the past four years.

(b) Hong Kong has so far signed seven tax information exchange agreements (“TIEAs”) with jurisdictions not interested in pursuing CDTAs with Hong Kong. All of these TIEAs were signed in 2014.

36. Moreover, following the Government’s indication to the Organisation for Economic Cooperation and Development (“OECD”) in September 2014 of Hong Kong's support for the new global standard on automatic exchange of financial account information (“AEOI”) in tax matters, we held briefing sessions for the relevant stakeholders in October 2014 to gauge their initial views on how AEOI should be implemented in Hong Kong. We will continue to keep close liaison with these stakeholders on the AEOI matter. Our current target is to work out the specific legislative proposals in 2015. We will further consult Members and the relevant stakeholders before submitting the relevant Bill to the LegCo in 2016. On the condition that Hong Kong could put in place necessary domestic legislation by 2017, the first information exchanges on a reciprocal basis with appropriate jurisdictions will commence by the end of 2018.

Review of Child allowance

37. In the context of fostering a supportive environment for forming and raising families, we will review the child allowance under salaries tax in the coming Budget. At present, a child allowance at the level of $70,000 is provided for each of the first to the ninth child, and an additional one-off child allowance at the level of $70,000 is provided in the year a child was born.

Financial Services and the Treasury Bureau

15 January 2015