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LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS

2016 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.

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 250,000 jobs which account for over 6% of the working population. Hong Kong's position as the world's financial centre is also widely recognised. The Global Financial Centre Index published by Z/Yen Group in September 2015 ranked Hong Kong third, only behind New York and London. Following the 2015 Article IV Consultation, the International Monetary Fund Mission affirmed that Hong Kong's robust financial system and prudent fiscal management would

help deal with near-term challenges, while laying the foundations for steady growth and healthy job creation in the medium term.

3. The global economy is subject to considerable challenges this year, with the complicated international monetary environment likely to pose a notable source of uncertainties. In particular, the US monetary policy normalisation has already started, but the future pace of its interest rate hikes remains highly uncertain. On the other hand, the European Central Bank continues to ease its monetary policy, thereby deepening the policy divergence. Coupled with the persistent slow and patchy global economic growth and heightened geopolitical risks in various regions, the adverse development could result in further gyrations in international financial conditions and capital flows, posing downside risks to the global economic outlook and financial stability.

4. The Government and regulators will stay vigilant under the uncertain external environment. 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. At the same time, the Government continues to press ahead with various initiatives to consolidate Hong Kong’s leading role as the Asia-Pacific region’s premier asset management centre, advance financial cooperation with the Mainland,

further develop our offshore Reminbi ("RMB") business and enhance market infrastructure and quality, boosting investor confidence.

New Initiatives

(a) *Asian Infrastructure Investment Bank ("AIIB")*

5. The AIIB came into operation in December 2015. We will continue to explore with the Central Government and the AIIB the specific arrangements for Hong Kong to join the AIIB. We will also discuss with the AIIB ways to leverage Hong Kong's capital markets, asset management professionals and various financial products to support the operation of the AIIB in areas such as project financing, bond issuance, investment, financial management and foreign exchange management.

(b) *Enhancing protection for borrowers*

6. To enhance protection for borrowers, we are liaising closely with the Police on its enforcement actions and experience, and are analysing the enforcement difficulties encountered. Subject to the outcome of the analysis, we will examine the existing regulatory arrangements of money lenders and related intermediaries and review the relevant provisions in the existing Money

Lenders Ordinance as necessary. We will also step up public education in relation to debt management.

Ongoing Initiatives

Promoting Market Development

(a) *Consolidating and enhancing Hong Kong's position as a major platform of capital raising and financing for Mainland and overseas enterprises*

7. The Government will capitalise on the opportunities arising from the implementation of the National 13th Five-year Plan and the "Belt and Road" Initiative to consolidate and enhance Hong Kong's position as a major platform of capital raising and financing for Mainland and overseas enterprises as well as a global hub for offshore RMB business. Hong Kong could also serve as a vital bridge between our country and countries along the "Belt and Road".

(b) *Islamic finance*

8. We are committed to create a platform to facilitate the development of Islamic finance, including strengthening the relevant market infrastructure,

manpower training, encouraging the development of Islamic financial products, and facilitating cooperation with other Islamic financial markets.

(c) *<u>Further advancing financial cooperation with the Mainland and offshore RMB business</u>*

9. Shanghai-Hong Kong Stock Connect has been operating smoothly since its launch in November 2014. It catalyses the two-way RMB fund flows between the onshore and offshore markets, and represents a historic milestone in the opening up of the Mainland's capital account. The connectivity with the Mainland stock market offered by the scheme provides investors with more RMB investment choices, and brings development opportunities to the financial intermediaries businesses in Hong Kong, while reinforcing Hong Kong's status as a premier international financial centre and offshore RMB business centre.

10. Hong Kong is the world's largest offshore RMB business hub and also Asia's leading fund raising and asset management centre. As at end November 2015, RMB deposits and outstanding RMB certificates of deposit exceeded RMB960 billion. RMB trade settlement handled by banks in Hong Kong was over RMB6.2 trillion in the first eleven months of 2015, representing an annual growth rate of 10%. Consistent growth is also observed in the RMB

loan business, with the outstanding amount exceeding RMB290 billion as at end November 2015, an increase of 58% as compared with end 2014.

11. To promote our offshore RMB business, we will continue to maintain close communication with relevant Mainland authorities with a view to deepening the mutual access between Hong Kong and Mainland financial markets and enhancing our RMB business links with overseas markets through betterment of market infrastructure and financial platforms.

(d) ***Consolidating Hong Kong's position as a premier asset management centre in Asia-Pacific***

12. With continuous economic growth and wealth creation in Asia, as well as increasing 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, broadening the variety and scope of our fund business as well as facilitating portfolio allocation by investors. As at end 2014, the asset under management of the fund management business in Hong Kong reached a record of HK$17.7 trillion, representing a year-on-year growth of 10.5% from 2013. To this end, the Government and regulators have been implementing various policy initiatives to remove existing limitation 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.

Mutual Recognition of Funds

13. The Mainland-Hong Kong Mutual Recognition of Funds Arrangement was implemented in July last year. So far, the Securities and Futures Commission has authorised 23 Mainland funds for public offerings in Hong Kong under the arrangement, whilst the China Securities Regulatory Commission has approved three Hong Kong funds for public offerings in the Mainland. Mainland and Hong Kong authorities would continue to authorise funds under the arrangement and further deepen the mutual access between the Mainland and Hong Kong capital markets. The successful implementation of the arrangement is of great significance not only to the development of the fund industry of both the Mainland and Hong Kong, but also the promotion of internationalisation of RMB. For Hong Kong in particular, this arrangement will expand the distribution network for Hong Kong's fund industry, and attract more funds to domicile in Hong Kong.

Open-ended Fund Company ("OFC")

14. To diversify our fund management platform, we will introduce an Amendment Bill into the Legislative Council (“LegCo”) by end January 2016 to introduce a new OFC structure in Hong Kong. This aims to expand Hong Kong’s legal structure for investment funds. The OFC proposal will allow funds to be set up in the form of a company, but with the flexibility to create and cancel shares for investors to trade the funds. The proposal will help attract more funds to domicile in Hong Kong and promote fund origination, thereby deepening and broadening our asset management activities. We aim to secure the passage of the Amendment Bill before summer this year. Upon the passage of the primary legislation, we will formulate the subsidiary legislation and the relevant Code, with a view to implementing the OFC regime as soon as practicable.

Creating a conducive tax environment

15. To attract multinational and Mainland corporations to establish corporate treasury centres in Hong Kong, we introduced the Inland Revenue (Amendment) (No.4) Bill into LegCo in December 2015. The Bill includes provisions to enhance the existing interest deduction rules for the intra-group financing businesses of corporations, and introduce concession on profits tax for qualifying corporate treasury centres. We are assisting the Bills Committee in examining the Bill.

(e) *Financial technologies ("Fintech")*

16. Fintech can enhance operational efficiency of the financial services industry and may have the potential of transforming traditional products and business processes. As an international financial centre with a highly developed information and communication technology sector, Hong Kong is an ideal place for developing Fintech. In April last year, the Government established the Steering Group on Fintech with members drawn from the industry, research and development institutions, relevant policy bureau and departments, as well as regulatory authorities to advise on how to develop Hong Kong into and promote Hong Kong as a Fintech hub. The Steering Group will soon produce its report with recommendations for the Government's consideration. Upon receipt of the report, the Government will study the recommendations before formulating a way forward.

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

17. The FSDC, established by the Government in 2013, has published 19 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 strengthen its 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.

<u>Enhancing Market Infrastructure and Quality</u>

(a) <u>Establishment of an independent Insurance Authority ("IIA")</u>

18. The Insurance Companies (Amendment) Ordinance 2015 (the Amendment Ordinance) which provides for a legal framework for the establishment of an IIA was enacted in July 2015. We have appointed members of IIA. The Amendment Ordinance is being implemented in phases. According to the Amendment Ordinance, IIA is now named the Provisional Insurance Authority which has administrative powers but not regulatory powers. It has started preparatory work for taking over the functions of the Office of the Commissioner of Insurance in the next stage. We will continue to maintain close dialogue with the industry to ensure a smooth transition to the new regime.

(b) <u>Preparing for establishment of a Policyholders' Protection Fund</u>

19. 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 relevant legislation.

(c) *Risk-based capital regime for the insurance industry*

20. Last year, we consulted the public on a risk-based capital regime for the insurance industry and stakeholders were in general support of the proposal. We will carry out quantitative impact studies and work out the detailed proposals, which aim 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.

(d) *Establishment of a resolution regime for financial institutions in Hong Kong*

21. In order to comply with the latest international standards arising from the relevant regulatory reform, we need to establish a resolution regime for financial institutions in Hong Kong. In this regard, the Government introduced the Financial Institutions (Resolution) Bill into LegCo in December 2015. The Bill aims to establish a regime for the orderly resolution of financial institutions with a view to avoiding or mitigating the risks otherwise posed by

their non-viability to the stability and effective working of the financial system of Hong Kong. We endeavour to enact the Bill by the current legislative session.

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

22. The Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015 was introduced into LegCo in October 2015 and is being scrutinised by a Bills Committee. The Bill aims to improve and modernise Hong Kong's corporate winding-up regime with a view to increasing protection of creditors, streamlining the winding-up process and further enhancing the integrity of the winding-up process.

23. In parallel, the Government has drawn up proposals to introduce a statutory corporate rescue procedure and insolvent trading provisions. We are engaging relevant stakeholders on the details for preparation of an amendment bill. Having regard to the scale and complexity of the legislative exercise, our target is to introduce the amendment bill into LegCo in the 2017-18 legislative session.

(f) *Auditor regulatory reform*

24. In view of international standards and practices, the Government has drawn up proposals to improve the regulatory regime for the auditors of listed entities with a view to enhancing the independence of the existing auditor regulatory regime from the audit profession. After issuing the public consultation conclusions on the reform proposals in June 2015, the Government is preparing an amendment bill and will continue to engage relevant stakeholders as we work out the details of the new regime. Our target is to introduce the amendment bill into LegCo in the 2016-17 legislative session.

(g) *Payment initiatives*

25. The regulatory regime for stored value facilities and retail payment systems under the Payment Systems and Stored Value Facilities Ordinance commenced operation in November 2015. Hong Kong Monetary Authority ("HKMA") is empowered to implement a mandatory licensing system for multi-purpose stored value facilities and perform relevant supervision and enforcement functions. A one-year period is allowed for existing issuers of stored value facilities or new market operators to apply for a licence from HKMA. The new regulatory regime will strengthen the public's confidence in the use of these products and services, and foster the development and innovation of the payment industry.

26. Also, with the Government's support, the local banking sector launched the e-Cheque service at the end of last year. The e-Cheque service offers an environmentally-friendly, safe and sound solution to enterprises and the public for handling payments, and promote the efficiency of Hong Kong's financial infrastructure. We look forward to the increasing usage of this service by the public.

(h) Countering money laundering and terrorist financing

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

Enhancing the Mandatory Provident Fund ("MPF") System

28. 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 70 funds were reduced last year. 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% or fund expense ratio of 1.3% or below) in each scheme, as at the end of last year, there were 180 [1] "low-fee funds" under 38 schemes. The MPF Schemes (Amendment) Bill 2014, which aims to simplify regulatory requirements and communication, add "terminal illness" as a new ground for early withdrawal of accrued benefits, and allow payment of accrued benefits by instalments, was passed by LegCo in January last year. The enhanced arrangements were implemented in August last year and will be fully implemented starting from February this year.

29. To further facilitate scheme members in making MPF investment that fulfills the long term retirement savings objective and drive down MPF fees, we introduced a Bill into LegCo in November last year, proposing that each MPF scheme should provide a highly standardised and fee-controlled "Default Investment Strategy" (formerly called "Core Fund") as an MPF default fund, in order to protect the interest of those scheme members who do not know how or do not want to make investment choices. We hope to secure early enactment of the Bill so as to implement the "Default Investment Strategy" by end 2016.

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[1] A constituent fund may comprise different fund classes. If each fund class is counted independently, the total number of low fee funds is 206.

THE TREASURY

Automatic Exchange of Financial Account Information in Tax Matters

30. 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, Hong Kong pledged in September 2014 our support for the new standard for automatic exchange of financial account information in tax matters ("AEOI"), which was promulgated by the Organisation for Economic Cooperation and Development ("OECD"), with a view to commencing the first exchanges with appropriate partners in 2018. To take the commitment forward, we have just introduced the Inland Revenue (Amendment) Bill 2016 into the Legislative Council, so as to put in place the legislative framework for implementing AEOI in Hong Kong. The Government adopts a pragmatic approach to include all essential requirements of the AEOI standard in our domestic law and would ensure effective implementation of the new standard. We aim to secure passage of the Amendment Bill by July this year.

Future Fund

31. We have established the Future Fund with effect from 1 January 2016 with an initial endowment of $219.7 billion notionally held against the Land Fund. This is one of the fiscal measures (in addition to stimulating economic growth, containing expenditure growth and stabilizing revenue base) to address the long-term fiscal sustainability problem arising from an aging population and slowing economic growth. The Future Fund will remain as part of the fiscal reserves. It seeks to secure higher investment returns through a placement with the Exchange Fund for an initial ten-year investment period with a view to yielding higher returns from the Long-Term Growth Portfolio of the Exchange Fund. The Future Fund is not a total solution but would help alleviate the pressure of our future generations.

Financial Services and the Treasury Bureau
13 January 2016