

**立法會**  
***Legislative Council***

LC Paper No. CB(1)1178/16-17  
(These minutes have been seen  
by the Administration)

Ref : CB1/PL/FA/1

**Panel on Financial Affairs**

**Minutes of meeting held on  
Thursday, 16 March 2017 at 9:30 am  
in Conference Room 3 of the Legislative Council Complex**

**Members present** : Hon Christopher CHEUNG Wah-fung, SBS, JP  
(Chairman)  
Hon Kenneth LEUNG (Deputy Chairman)  
Hon James TO Kun-sun  
Hon Abraham SHEK Lai-him, GBS, JP  
Hon Jeffrey LAM Kin-fung, GBS, JP  
Hon WONG Ting-kwong, SBS, JP  
Hon Starry LEE Wai-king, SBS, JP  
Hon CHAN Kin-por, BBS, JP  
Hon Paul TSE Wai-chun, JP  
Hon LEUNG Kwok-hung  
Hon Frankie YICK Chi-ming, JP  
Hon WU Chi-wai, MH  
Hon Charles Peter MOK, JP  
Hon CHAN Chi-chuen  
Hon Dennis KWOK Wing-hang  
Hon CHU Hoi-dick  
Dr Hon Junius HO Kwan-yiu, JP  
Hon Holden CHOW Ho-ding  
Hon SHIU Ka-fai  
Hon CHAN Chun-ying  
Hon Tanya CHAN  
Hon CHEUNG Kwok-kwan, JP  
Dr Hon YIU Chung-yim

**Members absent** : Hon Mrs Regina IP LAU Suk-yee, GBS, JP  
Dr Hon Fernando CHEUNG Chiu-hung

**Public officers attending** : Agenda Item IV

Mr James LAU, JP  
Under Secretary for Financial Services and the Treasury

Mr Paul WONG Yan-yin  
Principal Assistant Secretary for Financial Services and  
the Treasury (Financial Services)6

Agenda Item V

Ms Mable CHAN, JP  
Deputy Secretary for Financial Services and the  
Treasury (Financial Services)1

Miss Carrie CHANG  
Principal Assistant Secretary for Financial Services and  
the Treasury (Financial Services)1

Miss Renita AU  
Assistant Secretary for Financial Services and the  
Treasury (Financial Services)(1)1

Miss Chiu Po HUI  
Senior Assessor (Research)1  
Inland Revenue Department

Agenda Item VI

Mr Eddie CHEUNG Kwok-choi, JP  
Deputy Secretary for Financial Services and the  
Treasury (Financial Services)2

Mr YU Chun Keung, Leo  
Assistant Secretary for Financial Services and the  
Treasury (Preparatory Team)

Agenda Item VII

Ms Mable CHAN, JP  
Deputy Secretary for Financial Services and the  
Treasury (Financial Services)1

Ms Eureka CHEUNG  
Principal Assistant Secretary for Financial Services and  
the Treasury (Financial Services)5

Ms Karen Deborah KEMP  
Executive Director (Banking Policy)  
Hong Kong Monetary Authority

Mr Eamonn WHITE  
Head (Resolution)  
Hong Kong Monetary Authority

Mr Martin SPRENGER  
Head (Research and Development)  
Hong Kong Monetary Authority

Mr Andy CHEUNG  
Senior Manager (Banking Policy)  
Hong Kong Monetary Authority

Agenda Item VIII

Ms Elizabeth TSE, JP  
Permanent Secretary for Financial Services and the  
Treasury (Treasury)

Mr Andrew LAI, JP  
Deputy Secretary for Financial Services and the  
Treasury (Treasury)2

Mr Gary POON  
Principal Assistant Secretary for Financial Services and  
the Treasury (Treasury) (Revenue)

**Attendance by invitation : Agenda Item VI**

Dr Moses CHENG Mo-chi, GBM, GBS, JP  
Chairman  
Insurance Authority

Mr Stephen YIU Kin-wah  
Member  
Insurance Authority

Ms Fontaine CHENG Fung-ying  
Secretary  
Insurance Authority

**Clerk in attendance :** Ms Connie SZETO  
Chief Council Secretary (1)4

**Staff in attendance :** Mr Hugo CHIU  
Senior Council Secretary (1)4

Ms Sharon CHAN  
Legislative Assistant (1)4

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

(LC Paper No. CB(1)661/16-17 — Minutes of the special  
meeting on 14 December  
2016)

The minutes of the special meeting held on 14 December 2016 were confirmed.

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**II Information papers issued since the regular meeting on 6 February 2017**

(LC Paper No. CB(1)545/16-17(01) — Email dated 1 February 2017 from a member of the public on the proposed Bank of Communications (Hong Kong) Limited (Merger) Bill (English version only) (Restricted to members)

LC Paper No. CB(1)566/16-17(01), — Information papers provided (02) and (03) by Hon CHAN Chun-ying on the proposed Bank of Communications (Hong Kong) Limited (Merger) Bill ((01) is in Chinese version only while (03) is in English version only and restricted to members)

LC Paper No. CB(1)567/16-17(01) — Administration's paper on "Agreement Establishing the European Bank for Reconstruction and Development"

LC Paper No. CB(1)568/16-17 — Quarterly Report of the Securities and Futures Commission (October to December 2016))

2. Members noted the information papers issued since the regular meeting held on 6 February 2017.

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

(LC Paper No. CB(1)660/16-17(01) — List of outstanding items for discussion

LC Paper No. CB(1)660/16-17(02) — List of follow-up actions)

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3. Members agreed to discuss the following items proposed by the Administration at the next regular meeting scheduled for 18 April 2017:

- (a) Development of financial technologies;
- (b) Financial Institutions (Resolution) Ordinance - Commencement Notice and Protected Arrangements Regulation; and
- (c) Progress report on joint consultation on the proposed enhancements to the Stock Exchange of Hong Kong Limited's decision-making and governance structure for listing regulation.

4. Members further agreed that the meeting on 18 April would be held from 10:15 am to around 12:30 pm to allow sufficient time for discussion of the above three items.

**IV Hong Kong's participation and membership in the Asian Infrastructure Investment Bank**

(LC Paper No. CB(1)660/16-17(03) — Administration's paper on "Hong Kong's participation and membership in the Asian Infrastructure Investment Bank"

LC Paper No. FS03/16-17 — Fact sheet on Hong Kong's participation in the Asian Infrastructure Investment Bank prepared by the Research Office of Legislative Council Secretariat)

Briefing by the Administration

5. At the invitation of the Chairman, Under Secretary for Financial Services and the Treasury ("USFST") briefed members by a powerpoint presentation on Hong Kong's participation in the Asian Infrastructure Investment Bank ("AIIB"), and the latest progress of Hong Kong's application for membership. He said that the Government proposed to join AIIB with subscription of 7 651 shares, of which 1 530 would be paid-in shares (payable over five years) and 6 121 would be callable shares. The arrangement would require a payment of around HK\$240 million per year over a five-year period (i.e. a total payment of

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HK\$1.2 billion). Subject to members' views, the Government would submit the funding proposal to the Finance Committee ("FC") for approval in the second quarter of 2017. It was envisaged that Hong Kong could become a member of AIIB in mid-2017.

*(Post-meeting note: The powerpoint presentation materials (LC Paper No. CB(1)687/16-17(01)) were issued to Members vide Lotus Notes e-mail on 16 March 2017.)*

*(At 9:51 am, the Chairman ordered that the meeting be suspended to enable Panel members who were members of the Public Works Subcommittee ("PWSC") to vote on an item at the PWSC meeting concurrently held in Conference Room 1. The meeting resumed at 9:56 am.)*

## Discussion

### *Benefits for Hong Kong as a member of the Asian Infrastructure Investment Bank*

6. Mr CHAN Chun-ying supported the Administration's funding proposal for Hong Kong to become a member of AIIB. Noting that Hong Kong's companies and consultants had benefited from Hong Kong's membership in the Asian Development Bank ("ADB"), he enquired how Hong Kong's participation in AIIB would help the local industries and business sector. Mr CHAN also enquired whether Hong Kong's subscription of AIIB's callable shares would need to be guaranteed by the Central People's Government ("CPG").

7. Ms Starry LEE said that Members belonging to the Democratic Alliance for the Betterment and Progress of Hong Kong supported Hong Kong's joining AIIB to help Hong Kong tapping the opportunities arising from the Belt and Road Initiative and the Silk Road Fund. She enquired whether the Administration had assessed the benefits to Hong Kong after joining AIIB, and measures the Administration would take in assisting local companies and industries to tap the various opportunities.

8. Dr YIU Chung-yim declared that he was among the consultants of a research project financed by ADB. He suggested that the Administration should provide information on the cost and benefit analysis of Hong Kong's participation in ADB, which would facilitate FC's consideration of the relevant funding proposal. Pointing out that Hong Kong had joined ADB, Dr YIU asked why Hong Kong should join AIIB as he considered that the two were similar in nature.

9. On the benefits for Hong Kong in joining AIIB, USFST responded that these would depend on the investment appetite of local industries and companies for AIIB's projects. While it would be difficult to quantify the anticipated benefits

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at the moment, the Government observed that a number of Hong Kong companies including the Airport Authority Hong Kong and the MTR Corporation had been engaging in overseas infrastructure projects. He advised that it would be unnecessary for CPG to provide guarantee for Hong Kong's callable shares in AIIB as there was no such provision in the Articles of Agreement ("AoA") of AIIB.

10. USFST further pointed out that the annual return rate of ADB's ordinary capital resources stood at some 1.3% in the period from 2011 to 2015. Since AIIB started its operation only in 2016, there was no comparable data at this stage. The Government would monitor the operation and performance of AIIB and update Members as necessary. USFST said that AIIB and ADB had different objectives and the projects financed by them were also different in nature. In general, ADB's projects focused on poverty reduction in the least developed countries in Asia and were livelihood-related, and AIIB's projects on promoting sustainable infrastructure and improving cross-country connectivity in Asia. Projects financed by ADB were usually guaranteed by sovereign countries and ADB had no non-accrual loans since 2013. He said that the Government would endeavor to provide information on the cost and benefit analysis of Hong Kong's participation in ADB.

*(Post-meeting note: The Administration's supplementary information was issued to members vide LC Paper No. CB(1)763/16-17(02) on 3 April 2017.)*

*Establishment of a sub-office of the Asian Infrastructure Investment Bank in Hong Kong*

11. Mr Jeffrey LAM supported Hong Kong's participation in AIIB and conveyed support of the business sector for the proposal. He enquired about the progress of discussion with AIIB on an earlier proposal of establishing AIIB's corporate treasury centre ("CTC") in Hong Kong which he considered would benefit the local economy. He further urged the relevant bureaux/departments to examine the provision of auxiliary facilities (like housing and international schools for expatriates) to complement the possible establishment of AIIB's CTC in Hong Kong.

12. Ms Starry LEE concurred that the setting up of AIIB's CTC in Hong Kong would benefit Hong Kong. She considered that the Mainland's support on the matter would be vital given Hong Kong's relative small shareholding in AIIB.

13. USFST advised that the Government had been maintaining close contact with the Ministry of Finance of the People's Republic of China (which led the work in the establishment of AIIB) ("MoF"). The Government's liaison with



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MoF currently focused on Hong Kong's application for membership in AIIB. As regards the establishment of AIIB's sub-office, USFST pointed out that many members (both regional and non-regional) of AIIB had expressed interests in the matter. Apart from liaising with the Mainland authorities and AIIB, the Government would adopt other strategies, including the secondment of civil servants at the request of AIIB's management to assist the latter's operations, in order to strengthen Hong Kong's standing and credibility in the bid for AIIB to set up a sub-office in Hong Kong. He remarked that the financial services industry and the professional services sector would benefit if AIIB set up a sub-office in Hong Kong and issued its bonds in Hong Kong while the concrete benefits could only be quantified at a later stage.

14. Mr Kenneth LEUNG expressed support for the Administration's proposal. He enquired whether the Administration had examined issues relating to the legal status, privileges, immunities and exemptions of AIIB's office to be established in Hong Kong.

15. USFST advised that the International Organizations (Privileges and Immunities) (AIIB) Order ("the Order") had been tabled at the Council meeting on 11 May 2016 and come into operation on 11 July 2016. The Order sought to recognize the legal status of AIIB in Hong Kong, and accord the privileges and immunities as provided under the AoA of AIIB in Hong Kong's legal framework. He added that if AIIB set up a sub-office in Hong Kong, the Government would discuss with CPG and AIIB on another agreement to provide for appropriate exemptions (e.g. regarding taxation and immigration restrictions) for the sub-office and its personnel.

*Governance of the Asian Infrastructure Investment Bank*

16. Mr WU Chi-wai enquired about the composition of AIIB's Board of Governors and Board of Directors, their respective voting mechanisms, and how Hong Kong would appoint its representatives in AIIB upon becoming a member of the Bank, as well as how Hong Kong's views and interests could be represented in the Bank given the tiny shareholding of Hong Kong. Mr CHAN Chun-ying enquired about the appointment of Hong Kong's Governor and Alternate Governor in the Board of Governors of AIIB. Mr Jeffrey LAM asked whether a non-sovereign member of AIIB such as Hong Kong could become the Chairman of AIIB's Board of Governors.

17. USFST advised that each AIIB member including Hong Kong could appoint one Governor and one Alternate Governor on its own to AIIB's Board of Governors. The Board of Governors was the governing body of AIIB and had powers, among other things, to admit new members and make amendments to AoA. The Board of Directors, composed of 12 members elected by the

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Governors of AIIB with one Director returned from each of the 12 constituencies, would be responsible for the daily operations of AIIB. Each Director shall represent one or more members in a constituency. It was envisaged that Hong Kong would join the constituency covering the Mainland, and could participate in the election of AIIB Directors. Having regard to the experience of Hong Kong's membership in ADB, it was envisaged that Hong Kong could be elected as the Chairman of the Board of Governors of AIIB at some stage. As regards voting by members of AIIB, USFST said that in general, AIIB would decide matters by consensus, and only more important matters or the composition of constituency voting power would involve the counting of voting powers. USFST added that the rights and responsibilities of sovereign and non-sovereign members of AIIB would be the same. He agreed to provide supplementary information as requested by Mr WU Chi-wai.

*(Post-meeting note: The Administration's supplementary information was issued to members vide LC Paper No. CB(1)763/16-17(02) on 3 April 2017.)*

*Operation of the Asian Infrastructure Investment Bank*

18. Mr Holden CHOW expressed support for the Government's proposal. He called on the Administration to identify potential jurisdictions which AIIB would make investment in their infrastructure projects and built up relationship with the authorities concerned in order to enhance the opportunities for local companies in bidding the projects financed by AIIB ("AIIB's projects"). He enquired about the tendering process for AIIB's projects and whether AIIB or the jurisdiction initiating a project would determine the tender. Mr WU Chi-wai enquired about the procedures for bidding AIIB's projects.

19. As regards measures to help local industries and companies to leverage opportunities arising from Hong Kong's participation in AIIB, USFST advised that the Infrastructure Financing Facilitation Office ("IFFO") set up by the Hong Kong Monetary Authority ("HKMA") provided a platform to promote information exchange on infrastructure financing. IFFO could be requested to consider posting information link to AIIB's approved projects to promote awareness in Hong Kong. The information on AIIB's approved projects would in any event be on AIIB's website already. While the Government would not take the lead in bidding AIIB's projects, it would participate in relevant events of AIIB to promote Hong Kong's strength in financial and professional services. USFST further remarked that the industry could contact the Government if they wished to obtain more information about AIIB's operation and projects. On the bidding of AIIB's projects, USFST advised that the project proponent would determine both the tender arrangement for and the award of contract of the project. AIIB would develop procedures and guidelines for compliance by project proponents ensuring

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that tender exercises would be conducted in an open and transparent manner. The information on approved projects would be uploaded onto AIIB's website and accessible to the public.

20. In response to Mr WU Chi-wai's enquiry about why the projects financed by AIIB so far were concentrated in Central Asia, USFST said that as AIIB had just been established, it would be more efficient for it to co-finance infrastructure projects with other multilateral development banks such as the World Bank, ADB and the European Bank for Reconstruction and Development so that it need not start a project evaluation process from scratch. It was envisaged that AIIB would gradually increase investment in standalone projects proposed by members (which would be vetted by the Board of Directors of AIIB).

21. Noting that AIIB would adopt the relative share of the global economy of the relevant jurisdiction as the basic parameter for allocating the capital stock to its members, Mr Kenneth LEUNG enquired why the number of shares subscribed by Singapore (i.e. 2 500) was not commensurate with its share of the global economy, and whether AIIB would adopt a consistent formula in the allocation of its capital stock to various members.

22. USFST said that AIIB would allocate its capital stock to members having regard to individual members' relative shares of the global economy. Nevertheless, under-subscription (but not over-subscription) of shares by an AIIB member was allowed.

23. The Chairman noted that the AIIB Project Preparation Special Fund ("the Special Fund") had been established to provide grants to AIIB's less developed members to support and facilitate the preparation of projects to be financed by AIIB. He enquired about the financial implications on AIIB and Hong Kong if there were defaults on the Special Fund, and the difference in the return rates and associated risks of projects financed by AIIB's authorized capital stock and the Special Fund respectively.

24. USFST advised that AIIB members' contribution to the Special Fund was voluntary. Currently, China and the United Kingdom had donated US\$50 million and £40 million respectively to the Special Fund. The Special Fund was independent from the authorized capital stock of AIIB. He confirmed that the Government's proposal was about subscription of AIIB's capital, not donation to the Special Fund.

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Conclusion

25. The Chairman concluded that the Panel supported in principle the Government's plan to submit the relevant funding proposal to FC in the second quarter of 2017.

**V      Proposed amendments to the Inland Revenue Ordinance to extend profits tax exemption to onshore privately offered open-ended fund companies**

(LC Paper No. CB(1)660/16-17(04)      — Administration's paper on "Proposed extension of profits tax exemption to onshore privately offered open-ended fund companies"

LC Paper No. CB(1)660/16-17(05)      — Background brief on open-ended fund company structure prepared by the Legislative Council Secretariat)

Briefing by the Administration

26. With the aid of a powerpoint presentation, the Deputy Secretary for Financial Services and the Treasury (Financial Services)<sup>1</sup> ("DS(FS)1") briefed members on the legislative proposal to extend profits tax exemption to onshore privately offered open-ended fund companies ("subject OFCs"). She highlighted the development of OFC regime in Hong Kong, the existing taxation regime applicable to OFCs and the qualifying conditions for the proposed profits tax exemption. She said that the Government's target was to introduce the relevant amendment bill into the Legislative Council ("LegCo") in the second half of 2017.

*(Post-meeting note: The powerpoint presentation materials (LC Paper No. CB(1)687/16-17(02)) were issued to Members vide Lotus Notes e-mail on 16 March 2017.)*

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Discussion

*Conditions for profits tax exemption*

27. Mr CHAN Chun-ying expressed support for the legislative proposal. Noting that subject OFCs were required to meet the "not closely held" condition ("NCH condition") for a further 24-month period after the first 24-month period, he enquired how the Inland Revenue Department ("IRD") would monitor compliance with the proposed NCH condition. He also asked if IRD would consider issuing certificate of resident status to the subject OFCs with a view to facilitating them in seeking tax benefits in other tax jurisdictions which had signed Comprehensive Double Taxation Agreements with Hong Kong.

28. DS(FS)1 explained that the proposed 24-month-plus-24-month ownership requirement under the NCH condition had been formulated taking into account the industry's views that a reasonable period should be allowed for a subject OFC to meet the NCH condition since a fund would take some time to establish a track record and attract investors. The first 24-month period would start counting from the date the fund accepted its first investors. Further, to prevent a subject OFC from abusing the exemption from tax payment, it would be required to continue to meet the NCH condition for a further period of 24 months after the first 24-month start-up period. The second 24-month period aimed to prevent individuals or entities from taking advantage of the tax exemption in the first 24-month period by repeatedly opening and closing a subject OFC every 24 months. She added that there would be safe harbour rules allowing a subject OFC to seek tax exemption from the Commissioner of Inland Revenue if it failed to meet the NCH condition owing to certain circumstances, such as winding down of activities and investments and market fluctuations. With regards to tax residence, DS(FS)1 said that the subject OFCs would generally be regarded as tax residents of Hong Kong as their central management of control was exercised in Hong Kong and their regulated activities were carried out or arranged in Hong Kong by an investment manager. She added that the Organisation for Economic Co-operation and Development ("OECD") was formulating its position regarding tax treaty entitlements of investment vehicles in connection with the initiative to combat base erosion and profit shifting. The Government would monitor international developments in this regard to ensure that the issue of certificate of residence status to the subject OFCs was in accordance with international law.

29. Noting that the structure of funds varied, for instance, pension funds and sovereign wealth funds usually had a large fund size and a large number of investors, Mr CHAN Chun-ying enquired if the Administration would review the ownership requirement under the NCH condition in future, such as reducing the minimum number of investors in the subject OFC and relaxing the maximum

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30% participation interest by the originator and the originator's associates in the OFC. He also asked whether the Administration would consider granting stamp duty exemption to OFCs.

30. DS(FS)1 responded that the Government's intention was to attract funds with a larger number of investors and a reasonably large fund size to domicile in Hong Kong. The Government would review the effectiveness of the proposal in attracting the domiciliation of OFCs in Hong Kong at an appropriate juncture in future, and, if necessary, might consider adjusting the NCH condition as the circumstances might warrant. On the issue of stamp duty, she said that OFCs would be subject to the same stamp duty arrangements as unit trusts. Like transfer of units in non-listed unit trust schemes, transferring shares of non-listed OFCs by way of allotment and redemption would not be subject to stamp duty.

31. Mr Kenneth LEUNG sought details on the qualifying investors of privately offered OFCs and the classes of assets such funds would invest in. He further enquired whether the proposed profits tax exemption would also apply to other onshore privately offered funds (i.e. non-OFCs funds) if they could fulfill the proposed exemption conditions.

32. DS(FS)1 said that the investment scope of privately offered OFCs, whether onshore or offshore, should largely align with Type 9 regulated activity as defined under Schedule 5 of the Securities and Futures Ordinance (Cap. 571) ("SFO") which included securities (such as debt securities, options and collective investment schemes), futures contracts, and foreign exchange contracts. The relevant amendment bill would specify the permissible asset classes to be invested by OFCs for them to be eligible for profits tax exemption. Regarding qualifying investors, DS(FS)1 explained that qualifying investors referred to certain specified types of institution investors, including organizations established for non-profit-making purpose, pension funds, publicly offered funds and governmental entities. She further said that only onshore privately offered OFCs subject to regulation of SFO would be eligible for the proposed profits tax exemption.

33. Mr Kenneth LEUNG expressed concern that a small group of individuals might establish a company with an OFC structure to conduct securities transactions in order to avoid paying profits tax. He asked how the Administration would tackle the possible abuse.

34. DS(FS)1 said that in addition to the ownership requirement, a subject OFC should also meet the fund document requirement and terms and conditions requirement. Each of its investors would need to meet the participation interest requirements with respect to a minimum amount of investment made (i.e. \$200 million for a qualifying investor and \$20 million for a non-qualifying

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investor) and a maximum percentage shareholding allowed. Moreover, the investment management functions of a subject OFC must be carried out through or arranged by corporations or financial institutions ("FIs") licensed or registered under SFO. Similar to a conventional limited company, the subject OFC would need to have a constitutive document, namely the instrument of incorporation, and it would be governed by a board of directors who were subject to fiduciary duties. Given the above requirements and that offshore privately offered funds were already exempt from profits tax, there would be low incentive for companies to disguise as onshore privately offered OFCs in order to benefit from the current legislative proposal.

*Profits tax treatment for open-ended fund companies*

35. Mr CHAN Chun-ying noted that as a measure to prevent abuse, consideration or remuneration received by investment managers for providing investment services to tax-exempt OFCs in the course of a trade or business carried on in Hong Kong would be subject to profits tax. He asked whether such consideration or remuneration would be regarded as capital gain and hence could exempt from profits tax.

36. Senior Assessor (Research)<sup>1</sup> said that section 26(a) of the Inland Revenue Ordinance (Cap. 112) ("IRO") provided for profits tax exemption of dividends received from corporations which were chargeable to profits tax. Given that a subject OFC (which was a corporation) was chargeable to tax in respect of profits derived from transactions in "non-permissible asset classes", section 26(a) of IRO would apply which might create a loophole by which performance fees and carried interest paid out to investment managers in the form of dividends would be exempt from tax, when in fact such fees and interest were essentially income or profits (and hence should be chargeable to tax). The proposed provision was intended to plug this possible loophole.

37. Mr WONG Ting-kwong said that the Democratic Alliance for the Betterment and Progress of Hong Kong supported the legislative proposal in principle. As there might be an angle about tax avoidance in providing profits tax exemption to OFCs, he enquired whether the Government had assessed the impact of the proposal on tax revenue.

38. DS(FS)<sup>1</sup> advised that in processing applications for profits tax exemption, IRD would examine the financial statements of OFCs to see if the necessary conditions for tax exemption were met. IRD would also conduct risk-based review of the financial statements for preventing tax avoidance. She further said that the legal framework for OFC structure in Hong Kong was put in place in 2016 and was expected to commence operation in 2018 when the relevant subsidiary legislation and code were also in place. It was expected that the new OFC

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structure would enhance Hong Kong's attractiveness as a location for domiciliation of funds. This would in turn drive demand for professional services such as fund management and investment advice and generate tax revenue for the Government.

39. Ms Starry LEE supported the proposal as it could strengthen Hong Kong's fund business and asset management business. She asked why tax concessions were provided to fund companies but not other activities like research and development programmes carried out by corporations.

40. DS(FS)1 said that Hong Kong, being an international financial centre and offshore renminbi business centre, had a strong potential in developing its fund industry. In examining whether or not tax incentives would be given as one of the means to encourage the development of a certain industry/sector, consideration should be given to the merits of doing so having regard to policy considerations underlying the relevant case. Besides the fund industry, the Government had provided profits tax exemption to corporations setting up their CTCs in Hong Kong, and would soon introduce a legislative proposal to provide profits tax concessions to aircraft leasing business.

41. The Chairman asked if the Administration would consider assisting securities firms to obtain licences for conducting Type 9 regulated activity. DS(FS)1 said that the Administration would work with the Securities and Futures Commission to examine ways to assist the securities industry practitioners in meeting the relevant examination and licensing requirements for applying the Type 9 licence.

Conclusion

42. The Chairman concluded that members had no objection to the Government introducing the relevant amendment bill into LegCo in the second half of 2017.

**VI The independent Insurance Authority budget for the financial year 2017-2018**

(LC Paper No. CB(1)660/16-17(06) — Administration's paper on "Independent Insurance Authority budget for the Financial Year 2017-18"



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LC Paper No. CB(1)660/16-17(07) — Updated background brief on the Establishment of and financial arrangements for the independent Insurance Authority prepared by the Legislative Council Secretariat)

Briefing by the independent Insurance Authority

43. At the invitation of the Chairman, the Chairman, Insurance Authority ("C/IA") briefed members on the main features of the proposed budget of the independent Insurance Authority ("the Authority") for the financial year 2017-2018. He advised that the estimated income of the Authority for 2017-2018 was \$66.5 million while the estimated operating and capital expenditure were \$252.7 million and \$31.6 million respectively. He added that the Authority would, apart from discharging its statutory regulatory functions, liaise with stakeholders to promote sustainable development of the insurance industry. In this connection, the Authority had established the Future Task Force to explore the future of the insurance industry in Hong Kong.

Discussion

*Recruitment and remuneration of staff members of the independent Insurance Authority*

44. Mr CHAN Kin-por pointed out that the experience of staff of the Commissioner of Insurance ("OCI") would be valuable to the operation of the Authority. He enquired about the number of OCI staff members to be offered appointment by the Authority. He further expressed concern over the estimated expenditure of \$179.8 million on the Authority's staff cost for 2017-2018 as this would imply a high level of remuneration per staff member on average. He also sought details on the Authority's pay policy for staff, and cautioned that provision of "bonus" should not be linked with staff members' work in combating misconduct of insurance intermediaries lest staff members might be motivated to take enforcement actions in a less prudent manner.

45. Ms Starry LEE enquired how the Authority would determine the remuneration of its staff, and stressed that the Authority should decide on the matter carefully and prudently.

46. C/IA responded that the recruitment process of the Authority was in progress. It was envisaged that the Authority would recruit most OCI staff who had applied for the jobs. On staff remuneration, C/IA advised that the Authority

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had engaged a human resources consultant for recruitment matters and references to the salary levels of comparable positions in the market had been made in working out the remuneration packages of the Authority's staff. He pointed out that there were checks and balances in ensuring financial prudence of the Authority, including the arrangement for the Authority to brief the Panel on Financial Affairs on its proposed budget and the statutory requirement for the Authority to submit its budget for approval by the Financial Secretary. He assured members that the Authority would exercise vigilance in determining the remuneration of its staff. Indeed, there were cases where professionals in the market had accepted salary reduction in taking up appointments in the Authority. Member, Insurance Authority supplemented that the estimated staff costs of the Authority included mainly base pay, variable pay, contributions to the Mandatory Provident Fund schemes, staff insurance and employees' compensation insurance. Deputy Secretary for Financial Services and the Treasury (Financial Services)2 ("DS(FS)2") added that the variable pay for staff would be linked to their performance. Fines imposed by the Authority on disciplinary cases would be paid into the general revenue.

*Sustainable development of the insurance industry*

47. Ms Starry LEE supported the Authority's work in promoting the sustainable development of the insurance industry, and sought details on the work, including that of the Future Task Force. As a measure to enhance protection for policy holders and to minimize claims disputes, she suggested that the Authority should consider issuing guidelines to insurance companies with a view to standardizing certain key terms used in insurance policies, such as the definition of "terminal diseases".

48. C/IA advised that the Authority had been liaising with stakeholders in promoting the sustainable development of the insurance industry, and would implement measures focusing on areas including enhancing the image of the insurance industry, promoting continuous professional development of industry practitioners, attracting new talents to the industry, and enhancing consumer protection. He added that the Authority could not directly regulate individual insurance products but would take relevant measures (like rolling out public education programmes) to enhance consumers' awareness to protect their rights and interests in purchasing insurance products. Moreover, the industry had established an independent mechanism to handle claim disputes, and the Authority would soon commence preparatory work on the establishment of the Policy Holders' Protection Scheme.

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*Code of conduct for insurance intermediaries*

49. Noting that the Authority was expected to take over OCI's statutory functions in the second quarter of 2017, Mr CHAN Kin-por enquired about the progress in developing the code of conduct for insurance intermediaries.

50. DS(FS)2 advised that the Authority would implement the statutory licensing regime about one to two years after taking over OCI's regulatory functions. The Government, in collaboration with the existing three self-regulatory organizations, had established the Working Group of Transition ("WGT") to work out the detailed arrangements on transitional issues including developing the code of conduct for insurance intermediaries. WGT aimed to submit the draft code of conduct to the Authority in a few months' time for consultation with the industry. It was the target for the Authority to promulgate the code of conduct before commencement of the licensing regime.

51. Mr Kenneth LEUNG conveyed the industry's concern about the "best interests requirement" on licensed insurance intermediaries (i.e. an insurance intermediary must "act honestly, fairly, in the best interests of the policy holder concerned or the potential policy holder concerned, and with integrity"). He said that insurance agents were concerned that imposing the same "best interests requirement" on insurance brokers and insurance agents could create difficulties for insurance agents as, unlike insurance brokers, insurance agents also had to act in the interests of their appointing insurers. He called on the Authority to address the industry's concern.

52. C/IA responded that the Authority was aware of the concern mentioned by Mr Kenneth LEUNG, and would liaise with the industry on the matter when consulting the industry on the draft code of conduct for insurance intermediaries. He stressed that the code of conduct aimed to enhance professionalism of the insurance industry, and the Authority would strike a proper balance between catering for the needs of the industry and enhancing protection of policy holders.

**VII Proposed amendments to the Banking Ordinance to enable the implementation of international standards for banking regulation in Hong Kong**

(LC Paper No. CB(1)660/16-17(08) — Administration's paper on "Proposed amendments to the Banking Ordinance"

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LC Paper No. FS04/16-17

— Fact sheet on international standards for measuring and controlling large exposures prepared by the Research Office of Legislative Council Secretariat)

Briefing by the Administration

53. At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Financial Services)1("DS(FS)1") briefed members on the Government's plan to amend the Banking Ordinance (Cap.155) ("BO"). She said that the objectives of the proposed amendments were to:

- (a) bring Hong Kong's banking regulatory regime on the measuring and controlling of large exposures in line with the new framework released by the Basel Committee on Banking Supervision ("BCBS") in April 2014; and
- (b) empower the Monetary Authority ("MA") to require Authorized Institutions ("AIs") to prepare, maintain and implement recovery plans, reflecting the international standards on recovery planning set out in the Financial Stability Board's Key Attributes of Effective Resolution Regimes for FIs, for the purpose of restoring the financial resources and viability of AIs in cases where their non-viability could pose risks to the stability and effective working of the financial system of Hong Kong.

The Executive Director (Banking Policy) of the Hong Kong Monetary Authority ("ED(BP)/HKMA") gave a powerpoint presentation on the proposed amendments and comments gathered during the industry consultation.

*(Post-meeting note: The powerpoint presentation materials (LC Paper No. CB(1)687/16-17(03)) were issued to Members vide Lotus Notes e-mail on 16 March 2017.)*

Discussion

54. Mr Chan Chun-ying recognized the need to amend BO to bring Hong Kong's regulatory regime in line with the latest standards of BCBS. He urged HKMA to take into account views of the banking industry in drafting the new subsidiary legislation, and align the new requirements and implementation according to BCBS standards and timetable. He further called on the Government to make reference to the approach and time frame of other jurisdictions in

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implementing the new BCBS framework so that AIs in Hong Kong could maintain their competitiveness vis-à-vis their counterparts in other jurisdictions.

55. DS(FS)1 responded that it was the Government's target to introduce the relevant amendment bill into LegCo by the fourth quarter of 2017. This would allow time for the development of the necessary rules (i.e. subsidiary legislation under BO) by MA. ED(BP)/HKMA added that HKMA intended to align the reforms with the BCBS timetable and set the new framework generally in line with the exposure limits set by BCBS. It should facilitate the development by internationally active banks of the systems necessary to make the relevant calculations if the standards were consistent across different jurisdictions. HKMA would also observe the implementation of the new BCBS framework by other jurisdictions, and would further consult the banking industry when drafting the rules.

**VIII Update on Implementation of automatic exchange of financial account information in tax matters**

(LC Paper No. CB(1)660/16-17(09) — Administration's paper on "Update on implementation of automatic exchange of financial account information in tax matters"

LC Paper No. CB(1)660/16-17(10) — Updated background brief on automatic exchange of information for tax purposes prepared by the Legislative Council Secretariat)

Briefing by the Administration

56. At the invitation of the Chairman, the Permanent Secretary for Financial Services and the Treasury (Treasury) ("PS(Tsy)") briefed members on the background of the implementation of automatic exchange of financial account information in tax matters ("AEOI") in Hong Kong, the latest international developments requiring swift expansion in Hong Kong's AEOI network, and the legislative proposal to add 72 confirmed or prospective AEOI partners as Hong Kong's reportable jurisdictions in order to meet the latest international requirements.

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Discussion

57. Mr Kenneth LEUNG noted that the legislative proposal required FIs to identify and collect information on financial accounts of 72 additional confirmed or prospective AEOI partners to be included in the list of reportable jurisdictions with effect from 1 July 2017. Hong Kong would only exchange information with a reportable jurisdiction when a comprehensive avoidance of double taxation agreement ("CDTA") or a tax information exchange agreement ("TIEA") was in place together with a bilateral Competent Authority Agreement ("BCAA") signed with the jurisdiction on that basis for conducting AEOI. So far, Hong Kong had only signed a BCAA each with Japan, the United Kingdom and Korea for conducting AEOI starting from 2018 and 2019 respectively. Mr LEUNG enquired how the privacy of personal data would be protected in implementing AEOI in particular during the period between 1 July 2017 when the collection of data commenced and the actual exchange began, as well as the application of the Personal Data (Privacy) Ordinance (Cap. 486) in this regard.

58. PS(Tsy) said that IRD was obliged to protect personal data privacy and to ensure the confidentiality of the information collected. She reiterated that Hong Kong would conduct AEOI on a bilateral basis with partners with which Hong Kong had signed BCAAs. IRD would conduct AEOI only with partners who could meet relevant requirements on protection of privacy and confidentiality of information exchanged and ensure proper use of the data. The Deputy Secretary for Financial Services and the Treasury (Treasury)2 ("DS(Tsy)2") added that the Government had kept the Office of the Privacy Commissioner for Personal Data informed of the AEOI initiative and would ensure compliance with the relevant requirements in confidentiality and personal data privacy. The Government would also seek to expand Hong Kong's AEOI network swiftly, and consider the application of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ("Multilateral Convention") to Hong Kong for conducting AEOI.

59. Mr LEUNG Kwok-hung enquired about the legal framework for implementing AEOI in Hong Kong and the consequences if Hong Kong failed to meet the international standard in this regard. PS(Tsy) responded that IRO was amended in 2016 to put in place a legal framework for implementing AEOI, including the definition of FI and the information that FIs were required to collect and furnish to IRD. PS(Tsy) and DS(Tsy)2 further said that the international community had been closely monitoring jurisdictions' progress in the implementation of AEOI. In addition, OECD and the European Union ("EU") had kicked off their respective exercises to draw up lists of "non-cooperative tax jurisdictions". If Hong Kong did not have arrangements in place for AEOI with EU Member States or those jurisdictions which had indicated to OECD their interest in conducting AEOI with Hong Kong by end of 2017, Hong Kong could

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risk being labelled as a "non-cooperative tax jurisdiction" and be subject to counter-measures.

60. Mr CHAN Chun-ying asked about the Administration's criteria and approach in identifying AEOI partners, in particular measures taken or to be taken in minimizing compliance burden to FIs. PS(Tsy) clarified that the current proposal was to add 72 confirmed or prospective AEOI partners as Hong Kong's reportable jurisdictions. Since Hong Kong was not a party of the Multilateral Convention, Hong Kong had to take bilateral approach for discussing and signing BCAA. PS(Tsy) further said that having automatic exchange of information among tax authorities in September each year was a common timeframe for all jurisdictions taking part in the AEOI initiative.

Conclusion

61. Panel members had no objection to the Government's plan to introduce the relevant amendment bill into the LegCo in late March or April 2017.

**IX Any other business**

62. There being no other business, the meeting ended at 12:25 pm.

Council Business Division 1  
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