立法會
Legislative Council

LC Paper No. CB(1)1356/16-17
(These minutes have been seen by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of meeting held on
Monday, 5 June 2017 at 9:30 am
in Conference Room 1 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 Mrs Regina IP LAU Suk-yee, GBS, JP
Hon Frankie YICK Chi-ming, JP
Hon WU Chi-wai, MH
Hon Charles Peter MOK, JP
Hon CHU Hoi-dick
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 attending : Dr Hon Elizabeth QUAT, JP
Hon KWONG Chun-yu

Members absent : Hon Paul TSE Wai-chun, JP
Hon LEUNG Kwok-hung
Hon Dennis KWOK Wing-hang
Dr Hon Junius HO Kwan-yiu, JP

[According to the Judgment of the Court of First Instance of the High Court on 14 July 2017, LEUNG Kwok-hung, Nathan LAW Kwun-chung, YIU Chung-yim and LAU Siu-lai have been disqualified from assuming the office of a member of the Legislative Council, and have vacated the same since 12 October 2016, and are not entitled to act as a member of the Legislative Council.]

Public officers attending : Agenda Item III

Mr Paul CHAN, GBS, MH, JP
Financial Secretary

Mr Raymond WU
Administrative Assistant to Financial Secretary

Mrs Helen CHAN, JP
Government Economist

Agenda Item IV

Mr AU Ka Shing, Billy
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)4

Mr Paul F WINKELMANN
Chief Executive Officer
Financial Reporting Council

Ms LAM Wing Chi, Wincey
Deputy Chief Executive Officer
Financial Reporting Council

Agenda Item V

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

Mrs Karen HO
Consultant (Company Law)
Companies Registry

Miss Nancy YAU
Acting Deputy Registry Manager (Company Formation & Enforcement)
Companies Registry

Mr Jason CHU
Acting Chief Treasury Accountant (Financial Services)
Official Receiver's Office

Mr Alvin SIN
Acting Assistant Principal Solicitor (Advisory & Court Work)1
Official Receiver's Office

Agenda Item VI

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

Ms Pecvin YONG
Principal Assistant Secretary for Financial Services and the Treasury (Treasury) (Revenue)

Mr Brian CHIU, JP
Deputy Commissioner (Technical)
Inland Revenue Department

Mr Benjamin CHAN
Senior Assessor (Research)3
Inland Revenue Department

Ms Vivian NG
Acting Senior Assessor (Tax Treaty)6
Inland Revenue Department

Attendance by invitation	**:**	Agenda Item V Ms Christina CHOI Executive Director (Investment Products) Securities and Futures Commission Ms Grace CHAN Director (Investment Products) Securities and Futures Commission Ms Fiona TSE Senior Manager (Investment Products) Securities and Futures Commission Ms Joyce LEUNG Assistant Counsel (Legal Services Division) Securities and Futures Commission
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

Action

I Information papers issued since the regular meeting on 29 May 2017

Members noted that no information papers had been issued since the regular meeting held on 29 May 2017.

II Date of next meeting and items for discussion

(LC Paper No. CB(1)1030/16-17(01)	—	List of outstanding items for discussion
LC Paper No. CB(1)1030/16-17(02)	—	List of follow-up actions)

2. Members were informed that the Administration had not proposed items for discussion at the regular meeting on 3 July 2017. No members suggested discussion items for the meeting. Members had no objection to cancel the meeting on 3 July 2017.

(*Post-meeting note*: The Chairman decided to cancel the meeting scheduled for 3 July 2017 as the Administration had confirmed that it had no proposed discussion items for the meeting. Members were informed of the meeting arrangement vide LC Paper No. CB(1)1124/16-17 on 14 June 2017.)

III Briefing by the Financial Secretary on Hong Kong's latest overall economic situation

(LC Paper No. CB(1)945/16-17(01)	—	First Quarter Economic Report 2017 and the press release
LC Paper No. CB(1)1030/16-17(03)	—	Administration's paper on "Hong Kong's recent economic situation and near-term outlook")

Briefing by the Administration

3. At the invitation of the Chairman, the Financial Secretary ("FS") briefed members on Hong Kong's latest overall economic situation.

(*Post-meeting note*: The press release containing the speaking note of FS (Chinese version only) was issued to members vide LC Paper No. CB(1)1092/16-17(01) on 7 June 2017.)

4. The Government Economist ("G Econ") gave a powerpoint presentation on the latest developments in the Hong Kong economy, latest situation in the local

residential property market, and the economic outlook of the local and global economy in 2017.

(*Post-meeting note*: The notes of the powerpoint presentation (LC Paper No. CB(1)1078/16-17(01)) were issued to members vide Lotus Notes e-mail on 5 June 2017.)

Discussion

Macroeconomic conditions and measures to prepare Hong Kong for a possible financial crisis

5. Mr Jeffrey LAM welcomed that Hong Kong was ranked the world's most competitive economy for the second consecutive year in the International Institute for Management Development ("IMD") World Competitiveness Yearbook 2017. However, he expressed concern that Hong Kong's economic outlook was overcast by a number of potential problems including rising labour cost and continued surge in the property prices. Mr LAM enquired about measures taken by the Administration to mitigate risks arising from global uncertainties. Dr YIU Chung-yim echoed the concern about rising sentiments in protectionism and enquired how the Administration would tackle the issue. He further sought details of the Administration's measures to reduce risks arising from the possible strengthening of Hong Kong dollar ("HKD") on the local economy.

6. FS agreed that the global economy was overcast by a number of uncertainties including the US interest rate normalization and uncertainties surrounding policy and political developments in the United States ("US") and Europe. The Government would closely monitor relevant developments in the major economies including the US, the European Union ("EU"), Japan and the Mainland, and would work closely with the Hong Kong Monetary Authority ("HKMA") to maintain the financial stability of Hong Kong. FS pointed out that one of the major downside risks ahead was the uncertain pace of the US interest rate normalization and the scale-back of the US Federal Reserve's balance sheet, which might trigger large scale shifts in global capital flows. He added that the Government would closely monitor changes in the exchange rate of HKD, and stressed that Hong Kong would maintain its linked exchange rate system.

7. On the issue of trade protectionism, FS pointed out that there remained great uncertainties surrounding policy implementation in the US administration. Being a small and open economy, Hong Kong would inevitably be affected by protectionist policies in advanced economies. Hong Kong firmly supported free trade and would continue to conclude bilateral and multilateral agreements with its trading partners (like the free trade agreement with the Association of

Action

Southeast Asian Nations to be concluded within 2017). FS added that many participants of the Boao Forum for Asia 2017 affirmed their support for free trade.

8. The Chairman expressed concern about the risks arising from the overheated property market. He pointed out that Mr Joseph YAM (the former Chief Executive of HKMA) had recently remarked that the scale of the next round of global financial crisis might be larger than that in 2008, and the Secretary for Financial Services and the Treasury had also cautioned recently that there were warning signs of an imminent financial crisis (reflected by phenomena like abundance of capital supply, high valuation of many listed companies and the lack of crisis awareness among investors). He enquired about the precautionary measures the Government would take to prepare Hong Kong for a possible financial crisis.

9. FS responded that the Government attached importance to maintaining the financial stability of Hong Kong. The Government, HKMA and the Securities and Futures Commission ("SFC") had been closely monitoring developments in the financial market and had taken a number of measures (such as the eight rounds of counter-cyclical macroprudential measures introduced by HKMA on property mortgage lending) to enhance the resilience of the financial system. FS also pointed out that even in the event of a property market correction, the impact should be less severe as compared to the situation in 1997, as the current debt servicing ratio was lower and the problem of over-leveraging was not as serious. Besides, local banks had been maintaining a higher capital adequacy ratio and a lower classified loan ratio than their international counterparts. The Government would continue to stay alert and monitor the risks arising from the property market.

10. In response to Mr CHAN Chun-ying's enquiry about the reasons for the number of low-income elderly households reaching a record high in the first quarter of 2017, G Econ advised that the increase in the number of low-income elderly households reflected in large part the trend of ageing population. But she also pointed out that its proportion in all domestic households remained low at 0.3%.

The property market

11. Mr CHAN Chun-ying expressed concern about the continual surge in the local property prices. Pointing out that some property buyers had asked their family members who did not have residential property in Hong Kong ("eligible family members") to purchase flats in order to avoid paying the Special Stamp Duty and the new 15% flat rate of ad valorem stamp duty, Mr CHAN considered that investment activities in the residential property market had not slowed down

Action

as suggested in the Administration's discussion paper (i.e. LC Paper No. CB(1)1030/16-17(03)). He called on the Administration to collect relevant information and conduct more in-depth analyses on the investment activities in the residential market.

12. Sharing the concern about the over-heated property market, Mrs Regina IP considered that the Administration should collect data on the proportion of non-Hong Kong permanent residents buyers ("HKPRs") in the local property market. Referring to the purchase restrictions introduced in certain Mainland cities, she further suggested that the Administration should consider introducing mandatory restrictions on the sale and re-sale of properties in various new development areas ("NDAs") (including North East New Territories, Yuen Long South and Hung Shui Kiu) to HKPRs only. In her views, the measure could help check the rising property prices and vitalize the second-hand property market.

13. FS advised that the Government did not have statistics on the number of property transactions made by buyers who had asked their eligible family members to purchase the flats on their behalf. He cautioned that such activities involved high risks and could result in disputes among family members. He stressed that it would be a criminal offence for a party to circumvent the various demand-side management measures by asking another party to hold a property on its behalf (including through the use of the Declaration of Trust). Apart from criminal liability, buyers breaching the law would also be subject to penalty as high as 10 times of the stamp duty originally underpaid.

14. As regards the suggestion to impose purchase restrictions, FS said that, in formulating housing policies, the Government would "put Hong Kong people first". He said that it would be inappropriate for him to make any comment on the measures proposed by Mrs IP lest it might trigger a chaotic situation that people would rush to purchase flats in anticipation of such measures. Nevertheless, the Government would closely monitor developments in the property market and take necessary measures as appropriate.

15. Mr Jeffrey LAM suggested that the Administration should tackle the housing problem by increasing land supply, including through expediting the development of brownfield sites and green belt areas. Mr WU Chi-wai stressed the importance for the Administration to take various measures to provide affordable housing for the public.

16. Mr Holden CHOW was concerned that tightening of the loan-to-value ratio caps for residential mortgages (e.g. 60% for a residential property where the consideration was seven million HKD or below) might force a considerable

Action

number of prospective buyers to arrange top-up loans (i.e. second mortgages). This might have increased the transaction figures in the first-hand market recently as many property developers had offered top-up loans for the buyers. Mr CHOW cautioned about the negative impact of such development on the mortgage payment and affordability of buyers as the interest rates of top-up loans were much higher than those of ordinary mortgages. He enquired how the Administration would help the pubic in purchasing flats.

17. FS re-iterated the Government's determination to tackle the housing problem through increasing land supply and provision of subsidized housing. He also advised that the Government had examined the issue mentioned by Mr Holden CHOW. He cautioned that it would be inappropriate for the Government to relax the existing demand-side management measures and counter-cyclical macroprudential measures at this stage as this might send a wrong signal to members of the public and drive up property prices further.

18. FS further cautioned that there were high risks in the current property market, and potential property buyers should exercise prudence and consider their affordability before making decisions to purchase flats. In particular, potential home buyers should take full account of the increase in future flat supply and impending interest rate hikes. FS stressed that the total medium-term flat supply had already risen to a record high of 96 000. Also, the number of approved pre-sale flats in the period from January to May 2017 stood at 8 500, the highest over the same period in the past six years. The abundant supply of flats in the coming years could eventually affect both the prices and rentals of residential property.

19. Pointing out that high rental was one of the reasons leading to Hong Kong's high living cost, Dr Elizabeth QUAT enquired about the progress of the relocation of Government offices in commercial areas, such as Central and Wan Chai, in order to release the valuable sites for commercial use, and further measures to increase the supply of commercial land. Ms Starry LEE echoed that the operations of many companies had been hindered by high rentals. She enquired whether the Administration had information in this regard, and called on the Administration to tackle the issue of high rental.

20. Mrs Regina IP suggested that the Government should explore the feasibility of introducing a vacancy tax on commercial premises (particularly ground floor shops) so as to increase the supply of commercial premises and lower the rents.

21. FS advised that the issue of high rentals was partly attributable to the low vacancy rate of commercial buildings. He pointed out that the current term

Action

Government had successfully provided a total of 900 000 m^2 of commercial land to the market, which was 2.6 times the amount provided by the last term Government. Looking ahead, there would be a more abundant supply of commercial sites, most of which would be in new commercial districts including Kowloon East and Kai Tak Development Area. The Government had also reserved land for commercial use in the various NDAs. While the issue of high rentals could not be easily solved in the short run as the construction of new commercial buildings would take time, it was observed that the rental levels of some ground floor shops had softened or even declined. FS added that relocation of the existing Government offices in Wan Chai should also add to supply in the future.

22. On the question of rental cost, G Econ said that statistics on the share of rental costs in the total operating expenses were available from the Census and Statistics Department's annual economic surveys. Amongst the major economic sectors, the retail sector was more heavily affected by high rental cost and in more recent years, their operating environment had turned more difficult due to the setback of retail business.

> (*Post-meeting note*: The Administration's supplementary information was issued to members vide LC Paper No. CB(1)1154/16-17(02) on 16 June 2017.)

Measures to enhance Hong Kong's competitiveness

23. Mr CHAN Kin-por urged the Administration to promote the development of headquarters economy, which could bring a substantial number of high quality jobs to Hong Kong. He was concerned that the number of headquarters and regional offices established by foreign companies in Hong Kong were declining in recent years which had negative impact on the local economy.

24. Mr Charles Peter MOK remarked that the business sector had expressed concern about Hong Kong's economic outlook notwithstanding that Hong Kong had maintained its top competitiveness ranking by IMD. Mr MOK concurred that the Government should implement measures to attract foreign companies to set up and invest in Hong Kong, thereby creating more high-skill jobs for the local workforce. He also expressed concern about the relatively small number of high-tech companies establishing in Hong Kong, and considered it necessary for the relevant Government departments including InvestHK to explore new measures to attract foreign investment. He further called on the Government to review the existing policies and regulatory regimes to facilitate operational needs of high-tech companies, and to make reference to the practice of Singapore to establish a dedicated team to proactively reach out to foreign companies to

Action

provide advice and help them solve problems encountered in setting up business in Hong Kong. Mr MOK also suggested that the Government should examine the feasibility of offering subsidies to foreign companies recruiting local people.

25. Mr Kenneth LEUNG considered that Hong Kong should enhance its business facilitation measures, and suggested that FS should establish and chair an Investment Leading Group to coordinate the work of various bureaux/departments ("B/Ds") in addressing problems encountered by foreign enterprises in Hong Kong. Mr LEUNG also called on the Administration to strengthen measures to improve Hong Kong's living environment and air quality, including reviewing the existing policy on electric vehicles, and to formulate a competitive tax system. Ms Starry LEE echoed the need to enhance Hong Kong's tax regime, and enquired about the Administration's work in this regard.

26. FS took note of members' views and said that the Government would study the various suggestions as appropriate. He agreed that Hong Kong should promote regional headquarters economy and attract more foreign companies in order to diversify the economy. In this regard, he said that the Government had concluded bilateral tax treaties with a number of jurisdictions to boost the confidence of enterprises in such jurisdictions to invest in Hong Kong, and established more overseas Hong Kong Economic and Trade Offices and Liaison Units in the Mainland to promote Hong Kong. The Inland Revenue (Amendment) (No. 2) Ordinance 2016 which was enacted in May 2016 had also provided profits tax concessions to qualifying corporate treasury centres set up in Hong Kong. FS added that the Government would make reference to those effective measures adopted by other economies as appropriate. Also, Hong Kong had its own strengths like high transparency in policy formulation.

27. Regarding members' concern about Hong Kong's tax regime, FS advised that the tax policy unit had been established to study possible tax measures to foster the economic development while aligning with the relevant international standards (including those established by the Organisation for Economic Co-operation and Development and EU).

28. Mr Kenneth LEUNG relayed the concern of some foreign companies about insufficient international school places in Hong Kong for the children of expatriate staff working in Hong Kong. Mrs Regina IP enquired whether the Government would reconsider the proposal of constructing super-prisons so as to release the land resources for other purposes. She said that the society might not object the proposal.

29. FS responded that the Government would support the development of a vibrant international school sector mainly to meet the demand for school places

Action

from non-local families living in Hong Kong and families coming to Hong Kong for work or investment. He noted that the society had different views on the construction of super-prisons. The Government would examine the feasibility of consolidating the existing prisons on the Lantau Island.

30. While welcoming Hong Kong's top competitiveness ranking by IMD, Dr Elizabeth QUAT and Mr WU Chi-wai cautioned that Hong Kong's rankings in certain sub-categories of IMD including the cost of living, digital competitiveness and infrastructure were relatively low. Dr QUAT was concerned that the development of innovation technology in Hong Kong still lagged behind its main competitors (including Singapore) despite the establishment of the Innovation and Technology Bureau ("ITB") to promote the sector. She urged the Government to step up efforts in developing Hong Kong into a "Smart City" by first requiring various B/Ds to adopt innovation and technologies in their operations. Mr WU enquired about the work of the Committee on Innovation, Technology and Re-industrialization ("CITR").

31. FS responded that the Government would study carefully the relative strengths and weaknesses of Hong Kong economy as identified by IMD. He agreed that the Government should take forward various measures to address Hong Kong's high living cost and step up work in enhancing its innovation and technology infrastructure. He pointed out that the 2017-2018 Budget had allocated resources for promoting the development of innovation and technology in Hong Kong. The Government had also expanded the Public Sector Trial Scheme to encourage eligible start-ups to conduct trials of their products and services at public sector organizations. On the work of CITR, FS advised that it would formulate the blueprint for Hong Kong's innovation and technology development and re-industrialization.

Implementation of capital works projects

32. Mr WONG Ting-kwong sought FS's assessment of the impacts of filibuster in the Legislative Council ("LegCo") on the implementation of capital works projects. He remarked that FS should highlight the delay caused by filibuster in future briefings to provide the public with a clearer picture of the problem. Mr Jeffrey LAM echoed that there would be adverse effects on the Hong Kong economy if capital works projects could not be rolled out as scheduled.

33. FS responded that a large number of capital works projects was awaiting LegCo's approval. He said that the construction and engineering industry had expressed grave concern about the adverse impact on Hong Kong economy and livelihood of the general public due to delay of works projects by filibuster in

Action

LegCo. He called on LegCo Members to speed up the scrutiny of capital works projects. A case in point was the proposed works project on Tung Chung New Town Extension providing some 49 000 subsidized and private housing flat, which was essential for tackling Hong Kong's housing problem.

IV Annual briefing on the work of the Financial Reporting Council

(LC Paper No. CB(1)1030/16-17(04) — Financial Reporting Council's paper on "Progress Report on the work of the Financial Reporting Council"

LC Paper No. CB(1)1030/16-17(05) — Updated background brief on the work of the Financial Reporting Council prepared by the Legislative Council Secretariat)

Briefing by the Administration

34. At the invitation of the Chairman, the Chief Executive Officer, Financial Reporting Council ("CEO/FRC") briefed members on the work of the Financial Reporting Council ("FRC") in 2016 through a powerpoint presentation.

(*Post-meeting note*: The powerpoint presentation materials (LC Paper No. CB(1)1078/16-17(02)) were issued to Members vide Lotus Notes e-mail on 5 June 2017.)

Discussion

35. Mr CHAN Chun-ying enquired as to how soon Hong Kong's auditor regulatory regime would achieve independence and be in line with international standards. He noted that under the existing funding arrangement, FRC was jointly funded by the Companies Registry Trading Fund, the Hong Kong Exchanges and Clearing Limited ("HKEX"), the Hong Kong Institute of Certified Public Accountants ("HKICPA") and SFC. He asked whether the four parties would increase their respective shares of funding if FRC required more resources for undertaking its work.

36. CEO/FRC responded that the timetable of the relevant amendment bill for implementing the proposals of the auditor regulatory reform was in the hands of the Government who were preparing the amendment bill and he hoped that the

reform would be taken forward as soon as possible. With regard to funding, he advised that based on the Memorandum of Understanding signed among FRC and the four funding parties in 2014, the four parties would contribute on an "equal share" basis with a 5% annual increment until 2019. As additional staff had been recruited in 2016, FRC would consider deploying its reserves to meet the increase in staff costs. He added that FRC's budget was subject to approval by the Secretary for Financial Services and the Treasury.

37. Mr Holden CHOW enquired about the reasons for the significant increase in the number of complaints received by FRC from 25 in 2015 to 118 in 2016. Noting that SFC and HKEX would refer complaints about auditing or reporting irregularities of listed entities to FRC for investigation, he enquired about the differences between the work of FRC and other regulatory bodies.

38. CEO/FRC explained that in 2016 FRC had received a series of complaints, apparently from the same party, against one particular audit firm. After reviewing the handling of such complaints, FRC had introduced new measures to deal with vexatious complaints. Under the new measures, complaints identified as vexatious would be handled in a simplified manner and hence such complaints would not affect the resources in handling other complaints. Regarding FRC's regulatory work, CEO/FRC said that FRC would look into cases of auditing or reporting irregularities in the audit of financial statements of listed issuers and cases of non-compliance with accounting requirements by listed issuers. He pointed out that FRC would look solely at the accounting and auditing issues while SFC and HKEX would look into other matters such as non-compliance with the listing rules or other market misconduct issues.

39. Mrs Regina Ip remarked that there was a perception among small-sized accounting firms that FRC's investigation was targeted at them as audits performed by the "Big Four" accounting firms were seldom the subject of investigation. She also expressed concern about the difficulty encountered by small accounting firms in Hong Kong in bringing the audit working papers out of the Mainland for meeting FRC's requirements as disclosure of such documents might be prohibited by the Mainland laws and regulations for reason of "state secrets". She asked whether FRC was aware of the situation and urged FRC to assist small accounting firms to resolve the problem.

40. CEO/FRC stressed that FRC would not be biased when handling complaints against accounting firms, and would not avoid taking action against the "Big Four" accounting firms. Indeed, 31% of the pursuable complaints received in 2016 involved the "Big Four" accounting firms, 50% were against medium-sized accounting firms (i.e. firms with six or more partners/directors) while 19% were against small-sized accounting firms (i.e. firms with five or less

partners/directors). CEO/FRC stressed that FRC responded to complaints and did not target any firm because of its size. Regarding the difficulties encountered by small-sized accounting firms in bringing out audit working papers kept in the Mainland, FRC was aware of the situation and had been discussing with the Ministry of Finance and aimed to sign a memorandum of understanding with the Ministry of Finance on the access to audit working papers kept in the Mainland. He added that due to tightening of the relevant regulations in 2015 by the Mainland authorities, neither FRC nor HKICPA could access to audit working papers kept in the Mainland without the memorandum of understanding. Aware of the situation, FRC would not require the firms to hand over the audit working papers concerned until the memorandum of understanding with the Ministry of Finance was in place.

41. Mr Kenneth LEUNG noted that enhancing the professionalism and integrity of the auditing profession in Hong Kong was a stated mission of FRC. He asked, as FRC would be the future promulgator of auditing standards, what education programmes it would run so as to enhance the standard of the auditing profession and reduce the level of complaints in the long run.

42. CEO/FRC responded that under the proposals of the auditor regulatory reform, HKICPA would continue with its present duties in respect of registration; setting of standards in professional ethics, auditing and assurance; and setting of continuing professional development requirements for auditors of listed entities. FRC would be vested with oversight power over HKICPA's aforementioned functions. FRC would maintain close communications with the accounting and auditing profession to understand their difficulties.

V Subsidiary legislation and code relating to the open-ended fund company regime

(LC Paper No. CB(1)1030/16-17(06) — Administration's paper on "Subsidiary Legislation and Code Relating to the Open-ended Fund Company Regime"

LC Paper No. CB(1)1030/16-17(07) — Updated background brief on open-ended fund company structure prepared by the Legislative Council Secretariat)

Action

Briefing by the Administration

43. At the invitation of the Chairman and with the aid of a powerpoint presentation, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)1 ("PAS(FS)1") and Executive Director (Investment Products), Securities and Futures Commission ("ED/SFC") briefed members on the proposed Securities and Futures (Open-ended Fund Companies) Rules ("OFC Rules"), the proposed Code on Open-ended Fund Companies ("OFC Code"), and the proposed Fees Rules. They explained that LegCo enacted the Securities and Futures (Amendment) Ordinance 2016 ("the Amendment Ordinance") in June 2016 to put in place a legal framework for the open-ended fund company ("OFC") structure. SFC would make the OFC Rules and issue the OFC Code to set out the detailed legal and regulatory requirements for OFCs. The Fees Rules would be made by the Financial Secretary to prescribe the fees that SFC, Companies Registry and Official Receiver's Office would charge in respect of their functions and services to be carried out for an OFC. The OFC Rules and Fees Rules would be subsidiary legislation to be made under the Securities and Futures Ordinance (Cap. 571) ("SFO") and subject to negative vetting by LegCo. The OFC Code would not be subsidiary legislation and would be made by SFC under section 112ZR of SFO. SFC would launch a public consultation on the draft rules and code in June 2017. The finalized OFC Rules and Fees Rules, together with the commencement notice for the Amendment Ordinance, were expected to be tabled before LegCo for negative vetting in the first quarter of 2018, so that OFC regime could be implemented in the same year.

(*Post-meeting note*: The notes of the powerpoint presentation (LC Paper No. CB(1)1078/16-17(03)) were issued to members vide Lotus Notes e-mail on 5 June 2017.)

Discussion

Measures to prevent abuse of tax exemption under the open-ended fund company regime

44. Dr YIU Chung-yim enquired about measures to be taken by the Administration to prevent abuse of tax exemption granted to OFCs, including measures to plug the possible loophole where a company could disguise to be an OFC by packaging its business (like real estates) in the form of an OFC. PAS(FS)1 said that under the Inland Revenue Ordinance (Cap. 112) ("IRO"), publicly offered OFCs and OFCs with their central management and control ("CMC") located outside Hong Kong would already be exempt from profits tax. The Government would shortly introduce a bill to amend IRO to extend profits tax exemption to privately offered OFCs with their CMC located in Hong Kong

Action

("onshore privately offered OFCs"). The bill would include provisions specifying the conditions to be met by an OFC in order to be eligible for exemption and preventing abuse. She undertook to address Dr YIU's concerns by providing information on:

(a) relevant measures set out in IRO, the Amendment Ordinance, and the proposed amendment bill to extend profits tax exemption to onshore privately offered OFC ("the proposed amendment bill") to avoid the abuse of (i) stamp duty and profits tax exemption granted for OFCs; and (ii) exemption applicable to privately offered OFCs;

(b) measures to prevent a company from abusing the tax exemption for OFCs by packaging its business (like real estates) in the form of an OFC; and

(c) whether there would be any loophole for tax avoidance if the proposed amendment bill was not enacted by LegCo as scheduled.

(*Post-meeting note*: The Administration's supplementary information was issued to members vide LC Paper No. CB(1)1191/16-17(02) on 22 June 2017.)

Utilization and implementation of the open-ended fund company regime

45. Mr Kenneth LEUNG enquired about the types of investment funds that would likely adopt the OFC structure, and the assessment of the Administration and SFC on the future development of OFC structure becoming a popular investment fund vehicle. He also sought details on the segregated liability feature of sub-funds of umbrella OFCs, and enquired whether SFC would need to amend its Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products ("SFC Products Handbook") to complement the implementation of OFC regime.

46. PAS(FS)1 advised that the Amendment Ordinance had required OFCs to have an investment manager licensed or registered under SFO to carry out Type 9 (asset management) regulated activity. The investment scope should align with such regulated activity. Meanwhile, an allowance of a 10% de minimis limit would apply to privately offered OFCs to cater for their investment needs (i.e. a privately offered OFC could invest at maximum 10% of its total gross asset value in other asset classes). ED/SFC added that as understood from the industry, many overseas investors (particularly investors in continental Europe) were not familiar with the unit trust structure, therefore investment funds should be interested in using the OFC vehicle so that they could be structured in corporate form.

Action

47. ED/SFC also advised that section 112S of SFO provided for the segregation of liability of sub-funds (i.e. protected cell) for an umbrella OFC. To fortify the protected cell regime, the proposed OFC Rules would set out certain implied terms to be included in contracts and transactions entered into by an umbrella OFC as well as certain disclosure requirements for such an OFC. Such requirements would be in line with those for similar corporate fund vehicles in major overseas fund jurisdictions. As regards the application of SFC Products Handbook on OFCs, ED/SFC advised that SFC Products Handbook was applicable to different forms of SFC-authorized funds including those in corporate form. The specific legal and regulatory requirements for OFCs would be set out in the OFC Rules and OFC Code. There should be no conflict between the legislation of OFC regime and the SFC Products Handbook. It was not envisaged that amendments to the SFC Products Handbook would be necessary to cater for the implementation of OFC regime.

Measures to facilitate operation of the securities industry

48. The Chairman welcomed the "one-stop" process under the OFC regime to facilitate the establishment of investment funds in Hong Kong. He asked whether SFC would consider introducing similar arrangements for licence applications by practitioners of the securities industry. He expressed concern that it often took a long time for SFC to process licence applications from practitioners (particularly those involving changes in employers). The Chairman further enquired if securities firms would be allowed to sell investment funds set up under the OFC structure to overseas investors by the use of online client verification for client onboarding. He called on SFC to step up work in formulating the regulation regarding the use of online authentication by local securities firms.

49. ED/SFC explained that the "one-stop" process was proposed to enhance the establishment of OFCs as the process involved two parties (i.e. SFC and the Companies Registry). Such an arrangement was not applicable to the licence applications for practitioners of the securities industry as the applications concerned were solely handled by SFC. She added that the processing time of individual licence applications would depend on the complexity of the application concerned. SFC was open to communicating with the industry, and would keep in view any change to the application process as appropriate from time to time. ED/SFC noted the Chairman's concern and would relay the views to the Licensing Department of SFC.

50. Regarding the issue of client identity verification at the time of onboarding clients online , ED/SFC advised that SFC issued a circular in

Action

October 2016 on client identity verification in account opening processes, and would review the relevant requirements where appropriate .

Conclusion

51. The Chairman concluded that members had no objection to the Administration's plan to table the OFC Rules and Fees Rules before LegCo for negative vetting in the first quarter of 2018.

VI Application of Multilateral Convention on Mutual Administrative Assistance in Tax Matters in Hong Kong

(LC Paper No. CB(1)1030/16-17(08)	—	Administration's paper on "Application of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters in Hong Kong"
LC Paper No. CB(1)1030/16-17(09)	—	Updated background brief on automatic exchange of information for tax purposes prepared by the Legislative Council Secretariat)

Briefing by the Administration

52. At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Treasury)2 ("DS(Tsy)2") briefed members on the Government's plan of extending the application of the Multilateral Convention on Mutual Administration Assistance in Tax Matters ("Multilateral Convention") to Hong Kong, which would enable Hong Kong to adopt a multilateral approach for the implementation of automatic exchange of financial account information in tax matters ("AEOI") and the initiatives to combating Base Erosion and Profit Shifting. He said that the international community had been closely monitoring jurisdictions' progress in enhancing tax transparency and combat cross-border tax evasion. Both the Organisation for Economic Co-operation and Development ("OECD") and the European Union ("EU") had kicked off their respective exercises to draw up lists of "non-cooperative" tax jurisdictions by end of 2017. Participation in the Multilateral Convention was one of the three assessment criteria for OECD and EU in identifying "non-cooperative tax jurisdictions" in respect of tax transparency. Hong Kong faced a risk of not meeting the

Action

assessment criteria of OECD and EU in the absence of a wide AEOI network and not being a participant in the Multilateral Convention.

Discussion

53. Mr CHAN Chun-ying enquired about the procedures for Hong Kong to join the Multilateral Convention, given that the Multilateral Convention was only opened for signature by state parties.

54. DS(Tsy)2 advised that upon the request of Hong Kong, the Central People's Government ("CPG") had recently given in-principle approval to extend the application of the Multilateral Convention to Hong Kong. The Government had to amend IRO to provide for the legislative framework for Hong Kong to participate in the Multilateral Convention. Upon enactment of the amendment ordinance, the Government would seek CPG's assistance to deposit a declaration to OECD for territorial application of the Multilateral Convention to Hong Kong.

55. In response to Mr Kenneth LEUNG's enquiry about the legislative timetable of the relevant Inland Revenue (Amendment) Bill, DS(Tsy)2 said that the Financial Services and the Treasury Bureau was working with the Department of Justice on the amendment bill, and planned to introduce the bill into LegCo in October 2017.

56. Mr CHAN Chun-ying and Mr Holden CHOW noted that "simultaneous tax examinations" was one of the mandatory provisions of the Multilateral Convention, but it would be up to a party to decide whether to participate in a particular examination (i.e. item (e) in paragraph 14 of LC Paper No. CB(1)1030/16-17(08)). Mr CHAN further noted that the Government's position that Hong Kong would not participate in any simultaneous tax examinations and enquired about the reasons involved. Mr CHOW sought details on the purpose of conducting simultaneous tax examinations.

57. Deputy Commissioner (Technical), Inland Revenue Department, ("DCIR(T)") explained that simultaneous tax examination referred to an arrangement which jurisdictions, each in its own territory, to examine tax affairs of persons in which they had a common or related interest, with a view to exchanging any relevant information which they so obtained. Given that Hong Kong had been practising a territorial-based tax regime, it appeared unlikely that Hong Kong would need to conduct tax examinations with other jurisdictions. It was therefore the Government's policy that Hong Kong, as a general rule, would not participate in any simultaneous tax examinations. In addition, Hong Kong would not accept requests from other jurisdictions allowing their representatives to be present at a tax examination of Hong Kong given that "tax examinations

Action

abroad" was an optional provision of the Multilateral Convention (i.e. item (f) in paragraph 14 of LC Paper No. CB(1)1030/16-17(08)).

58. Mr YIU Chung-yim enquired about the types of taxes that Hong Kong intended to cover under the Multilateral Convention and additional manpower and resources the Inland Revenue Department ("IRD") would require in coping with the increased workload arising from the extension of Multilateral Convention to Hong Kong.

59. DCIR(T) advised that a wide range of taxes were covered under the Multilateral Convention and Hong Kong would only provide assistance on information exchange for taxes on income or profits, taxes on capital gains which were imposed separately from the tax on income or profits, and taxes on net wealth (i.e. the minimum requirement under the Multilateral Convention). As regards the additional manpower and resources required by IRD, DS(Tsy)2 said that participation in the Multilateral Convention, including the expansion of AEOI network through the Convention, would inevitably increase the workload of IRD. DCIR(T) supplemented that at present, IRD handled about 400 exchange of information requests a year from jurisdictions with which Hong Kong had entered into a comprehensive avoidance of double taxation agreement or a tax information exchange agreement. IRD would review its manpower situation and consider seeking resources for strengthening its manpower through the established mechanism where necessary.

60. Mr Kenneth LEUNG enquired about the relationship between the 111 jurisdictions as listed out at Annex B to the discussion paper (LC Paper No. CB(1)1030/16-17(08)), the 100 jurisdictions which had signed up for the AEOI initiative, and the jurisdictions to be included in the list of reportable jurisdictions as proposed in the Inland Revenue (Amendment) (No.3) Bill 2017.

61. DS(Tsy)2 said that Annex B to the discussion paper had listed out 111 jurisdictions which participated in the Multilateral Convention as at 12 May 2017. He explained that the purpose of the Inland Revenue (Amendment) (No.3) Bill 2017 was to include 73 confirmed or prospective AEOI partners (among the 100 jurisdictions which had signed up for the AEOI initiative) as Hong Kong's reportable jurisdictions, on top of the two already included in the list (i.e. Japan and the United Kingdom). The prospective partners included jurisdictions which had expressed an interest to OECD in conducting AEOI with Hong Kong, Hong Kong's tax treaty partners which had committed to AEOI, or Member States of EU.

Action

Conclusion

62. Panel members had no objection to the Government's plan to introduce the relevant amendment bill into LegCo in October 2017.

VII Any other business

63. There being no other business, the meeting ended at 12:27 pm.

Council Business Division 1
Legislative Council Secretariat
3 August 2017