

立法會
Legislative Council

LC Paper No. CB(1)1305/17-18
(These minutes have been seen
by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

**Minutes of meeting held on
Tuesday, 15 May 2018, at 9:30 am
in Conference Room 1 of the Legislative Council Complex**

Members present : Hon Kenneth LEUNG (Chairman)
Hon Christopher CHEUNG Wah-fung, SBS, JP
(Deputy Chairman)
Hon James TO Kun-sun
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon WONG Ting-kwong, GBS, JP
Hon Starry LEE Wai-king, SBS, JP
Hon CHAN Kin-por, GBS, JP
Hon Paul TSE Wai-chun, JP
Hon WU Chi-wai, MH
Hon Charles Peter MOK, JP
Hon Dennis KWOK Wing-hang
Ir Dr Hon LO Wai-kwok, SBS, MH, JP
Hon CHU Hoi-dick
Hon Holden CHOW Ho-ding
Hon SHIU Ka-fai
Hon CHAN Chun-ying
Hon CHEUNG Kwok-kwan, JP

Members absent : Hon Abraham SHEK Lai-him, GBS, JP
Hon Mrs Regina IP LAU Suk-ye, GBS, JP
Hon Alvin YEUNG
Dr Hon Junius HO Kwan-yiu, JP
Hon LUK Chung-hung

Public officers attending : Agenda Item IV

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

Agenda Item V

Mr Norman T. L. CHAN, GBS, JP
Chief Executive
Hong Kong Monetary Authority

Mr Eddie YUE, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Arthur YUEN, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Howard LEE, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Darryl CHAN, JP
Executive Director (Corporate Services)
Hong Kong Monetary Authority

Agenda Item VI

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

Agenda Item VII

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

Ms Joan HUNG
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services) Special Duties

**Attendance by
Invitation** : Agenda Item IV

Mr Paul F WINKELMANN
Chief Executive Officer
Financial Reporting Council

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

Agenda Item VI

Mr Keith CHOY
Senior Director (Intermediaries Supervision,
Intermediaries)
Securities and Futures Commission

Ms Joanne LI
Director (Intermediaries Supervision, Intermediaries)
Securities and Futures Commission

Ms Elise CHEUNG
Manager (Intermediaries Supervision, Intermediaries)
Securities and Futures Commission

Ms Sandra KING
Senior Legal Consultant (Legal Services Division)
Securities and Futures Commission

Agenda Item VII

Ms Carol HUI
Executive Director (Long Term Business)
Insurance Authority

Mr Marty LUI
Associate Director (Long Term Business)
Insurance Authority

Ms Gabriella YEE
Executive Director (Policy)
Mandatory Provident Fund Schemes Authority

Ms LEE Cheung-mei
Senior Manager (Policy Development)
Mandatory Provident Fund Schemes 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)830/17-18 | — Minutes of the special meeting on 8 January 2018 |
| LC Paper No. CB(1)883/17-18 | — Minutes of the meeting on 5 February 2018 |
| LC Paper No. CB(1)924/17-18 | — Minutes of the meeting on 5 March 2018) |

The minutes of the meetings held on 8 January 2018, 5 February 2018 and 5 March 2018 were confirmed.

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II Information papers issued since the regular meeting on 3 April 2018

- (LC Paper No. CB(1)781/17-18(01) — Report on the Mandatory Provident Fund Schemes (Amendment) Ordinance 2015
- LC Paper No. CB(1)885/17-18(01) — Hong Kong Monetary Authority Annual Report 2017
- LC Paper Nos. CB(1)940/17-18(01) and (02) — Letter dated 3 April 2018 from Hon Dennis KWOK on issues relating to the regulation and development of cryptocurrencies (Chinese version only) and the Administration's response)

2. Members noted the information papers issued since the regular meeting held on 3 April 2018.

III Date of next meeting and items for discussion

- (LC Paper No. CB(1)926/17-18(01) — List of outstanding items for discussion
- LC Paper No. CB(1)926/17-18(02) — List of follow-up actions)

3. Members agreed to discuss the following items proposed by the Administration at the regular meeting scheduled for 4 June 2018, from 10:00 am to 12:45 pm:

- (a) Briefing by the Financial Secretary on Hong Kong's latest overall economic situation ("FS's briefing");
- (b) Proposed amendments to remove ring-fencing features from the tax regimes for offshore funds;
- (c) Legislative proposals to update the financial resources requirements for licensed corporations; and

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- (d) Proposed Amendments to the Occupational Retirement Schemes Ordinance (Cap. 426).

4. Referring to Hon Dennis KWOK's letter dated 3 April 2018 on issues relating to the regulation and development of cryptocurrencies in which he proposed that the Panel should discuss the subject (LC Paper No. CB(1)940/17-18(01)), Mr Charles Peter MOK remarked that the Administration's written response (LC Paper No. CB(1)940/17-18(02)) had not addressed Mr KWOK's concerns. He suggested that the subject should be included in the Panel's list of outstanding items for discussion.

5. The Chairman said that members could raise questions on the subject during the briefing on Hong Kong Monetary Authority's ("HKMA") work at today's meeting. Members could also take the opportunity of FS's briefing at the Panel meeting on 4 June 2018 to discuss related issues. If necessary, further discussion on the subject would be scheduled at a future meeting.

6. Mr CHAN Chun-ying considered that the Panel should discuss the development of Guangdong-Hong Kong-Macao Bay Area ("the Bay Area") (i.e. item 8 of the Panel's list of outstanding items for discussion) as soon as possible. The Chairman said that the Panel on Commerce and Industry, the Panel on Economic Development, the Panel on Financial Affairs, and the Panel on Information Technology and Broadcasting conducted a joint-Panel visit to the Bay Area in late April 2018 and would hold a joint-Panel meeting to discuss the development in the Bay Area. He would discuss with the Chairmen of the other three Panels to explore holding the joint-Panel meeting in July 2018.

(Post-meeting note: On the Chairman's instruction, the Financial Secretary's Office was informed that the Panel would take the opportunity of FS's briefing to discuss the subject of (a) regulation and development of cryptocurrencies; and (b) establishing a sovereign wealth fund for Hong Kong. Members were informed of the arrangement vide LC Paper No. CB(1)973/17-18 on 18 May 2018.)

IV Annual briefing on the work of the Financial Reporting Council

(LC Paper No. CB(1)926/17-18(03) — Financial Reporting Council's paper on "Progress Report on the work of the Financial Reporting Council"

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LC Paper No. CB(1)926/17-18(04) — Updated background brief on the work of the Financial Reporting Council prepared by the Legislative Council Secretariat)

Briefing by the Financial Reporting Council

7. 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 2017 through a powerpoint presentation.

(*Post-meeting note:* The powerpoint presentation materials (LC Paper No. CB(1)967/17-18(01)) were issued to members vide Lotus Notes e-mail on 16 May 2018.)

Discussion

Publicity work of the Financial Reporting Council

8. Mr CHAN Chun-ying invited FRC to elaborate on the work of its Corporate Communications Committee, including whether it would proof-read papers submitted by FRC to the Legislative Council ("LegCo"). Mr WONG Ting-kwong remarked that many members of the public were still unaware of the work of FRC though it had been established for 10 years. He enquired whether FRC would step up publicity to promote its roles and functions.

9. CEO/FRC advised that one staff member was responsible for FRC's corporate communication, the duties of whom included revamping and updating FRC's website, preparing its annual report, handling media enquiries and preparing press announcements for completed investigations. He added that the staff would take various steps to enhance the publicity work of FRC.

Investigation and enquiry work of the Financial Reporting Council

10. Mr Christopher CHEUNG noted that 40 investigations conducted by FRC were still underway as at the end of 2017, and that some of such investigations could not be pursued until FRC had concluded a Memorandum of Understanding ("MOU") with the Ministry of Finance ("MoF") which, inter alia, allowed FRC to access audit working papers in the Mainland. He enquired when the MOU would be concluded, and about the respective numbers of investigations in progress which involved newly listed companies, Mainland companies listed in Hong Kong, and required access to audit working papers in the Mainland.

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Mr CHEUNG further called on FRC to expedite its work in concluding the MOU. Echoing the concern, Mr WU Chi-wai and Mr CHAN Chun-ying enquired about the timetable for concluding the MOU with MoF and difficulties encountered by FRC in the process. They further asked if passage of the Financial Reporting Council (Amendment) Bill 2018 ("the Bill") currently under scrutiny by LegCo could expedite conclusion of the MOU.

11. CEO/FRC advised that he could not disclose details of any investigation in progress. He remarked that the progress of investigations not involving access to audit working papers in the Mainland was relatively satisfactory.

12. As regards regulatory work involving Mainland auditors, CEO/FRC pointed out that currently only 56 out of some 2 000 listed companies in Hong Kong had engaged qualified Mainland auditors. He explained that this was under a "convergence scheme" subject to an agreement between a number of relevant parties including the Financial Services and the Treasury Bureau ("FSTB"), FRC, the Hong Kong Institute of Certified Public Accountants ("HKICPA"), the Hong Kong Exchanges and Clearing Limited, the Securities and Futures Commission ("SFC"), MoF, the China Securities Regulatory Commission and the Chinese Institute of Certified Public Accountants. He acknowledged that currently there was difficulty for FRC in gaining access to the audit working papers kept in the Mainland. In this connection, FRC had been liaising with MoF on an MOU. It was envisaged that the passage of the Bill, which sought to enhance FRC's regulatory powers, would be conducive to the negotiation. While FRC could not provide a concrete timetable at this moment, it was FRC's target to conclude the MOU around the same time as the commencement of the new regulatory regime for auditors of public interest entities.

13. Mr WU Chi-wai noted that of the over 400 complaints received and handled by FRC from 2007 to 2017, FRC had completed 56 investigations and 11 enquiries. He sought details of the latest position of the remaining complaints. Mr WONG Ting-kwong enquired about the results of the complaints which FRC had referred to specified enforcement agencies, and whether FRC would monitor the progress of the referred cases.

14. CEO/FRC advised that among the 400 complaints received by FRC, some 200 were received in 2016 and 2017 which apparently came from the same source and were directed at one audit firm. While none of these complaints met the required investigation threshold, FRC had referred to HKICPA for necessary follow-up. As FRC understood, HKICPA did not consider any investigation was warranted for the complaints referred. FRC had also been informed by the audit firm concerned that it had already undertaken remedial actions. He added that

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some of the remaining complaints were either dismissed or fell outside FRC's ambit. FRC had also referred relevant complaints to other agencies for follow-up as necessary. CEO/FRC further remarked that FRC would monitor the progress of complaints referred to HKICPA during its quarterly meetings with HKICPA. Of the 69 cases referred to HKICPA since FRC's inception, 39 cases ended up with sanctions while the remaining 30 cases were still under HKICPA's disciplinary process.

Composition of the Financial Reporting Council

15. Mr Holden CHOW noted FRC's position that Hong Kong could further enhance global confidence in its auditor regulatory regime by obtaining the European Commission regulatory equivalence status ("ECES"). One of the ECES' requirements was that the governing body of the independent auditor regulator must comprise solely non-practitioners. He also noted the auditing industry's concern about the appropriateness for the post-reform FRC to consist of non-practitioners only as non-practitioners would not be familiar with the operation of the industry. Mr CHOW enquired whether the Administration would consider changing the composition of the post-reform FRC.

16. Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)⁴ advised that under the Bill the composition of the post-reform FRC was as follows:

- (a) the Chief executive ("CE") would appoint at least nine non-executive and executive directors;
- (b) the number of non-executive directors of FRC must exceed the number of executive directors;
- (c) out of the members appointed by CE, at least two persons should possess knowledge of and experience in public interest entity engagements; and
- (d) the number of members who were non-practitioners must exceed the number of members who were practitioners.

He said that the Administration was aware that various stakeholders had diverse views on the composition of the post-reform FRC. On the one hand, some supported FRC to comprise solely non-practitioners to enable it to meet ECES' relevant requirement. On the other hand, some considered that the number of practitioners should be increased in order to ensure that FRC possessed relevant and up-to-date audit skill, knowledge and experience. The Administration

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considered the proposed composition of FRC as provided in the Bill appropriate having regard to the main purposes of the Bill of enhancing the independence of FRC for better investor protection, and enabling Hong Kong to join the International Forum of Independent Audit Regulators.

V Briefing on the work of Hong Kong Monetary Authority

(LC Paper No. CB(1)926/17-18(05) — Paper provided by the Hong Kong Monetary Authority)

Briefing by the Hong Kong Monetary Authority

17. At the invitation of the Chairman, the Chief Executive, Hong Kong Monetary Authority ("CE/HKMA"), the Deputy Chief Executive (Banking), Hong Kong Monetary Authority ("DCE(B)/HKMA"), the Deputy Chief Executive (Monetary), Hong Kong Monetary Authority ("DCE(M)/HKMA") and the Deputy Chief Executive (Development), Hong Kong Monetary Authority ("DCE(D)/HKMA") updated members on the work of HKMA through a powerpoint presentation. Topics included assessment of risks to Hong Kong's financial stability, banking supervision, financial infrastructure, development of the financial market, investment performance of the Exchange Fund ("EF"), and the Hong Kong Mortgage Corporation's ("HKMC") Life Annuity Scheme ("LAS").

(*Post-meeting note:* The powerpoint presentation materials (LC Paper No. CB(1)967/17-18(02)) were issued to Members vide Lotus Notes e-mail on 16 May 2018.)

Discussion

Macroeconomic conditions and the impacts of interest rate normalization

18. Ir Dr LO Wai-kwok expressed concern about the uncertainties arising from the trade conflicts between China and the United States ("the US"). Pointing out that around two-third of Hong Kong's trade exports were electronic products and components, Dr LO sought HKMA's assessment of the possible impacts of China-US trade conflicts on Hong Kong.

19. Mr Christopher CHEUNG was concerned that the potential adverse impacts of the China-US trade conflicts might be massive although HKMA considered that Hong Kong's resilience to external shocks had been significantly

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enhanced. He enquired whether HKMA had assessed the possible impacts on Hong Kong's stock and property markets if China-US trade conflicts dragged on for some time, and discussed with relevant parties including the Financial Secretary, FSTB, and the Commerce and Economic Development Bureau in formulating contingency plans.

20. CE/HKMA said that there would be no winner in a trade war. The global supply chains involved numerous economies, so other regions including Japan, Korea and Taiwan could also be affected by the trade conflicts. At this stage, however, it was difficult to assess the impacts of the trade conflicts on Hong Kong as negotiations between the two parties were still underway. HKMA would ensure the proper functioning of Hong Kong's banking system to prevent a break in the credit chain and abrupt tightening of credit, which would severely affect the operations of many companies.

21. Mr WONG Ting-kwong enquired why the interest rates of the Hong Kong dollar ("HKD") remained at low levels even with the continuous buying of HKD by HKMA when the weak-side Convertibility Undertaking was triggered under the operation of the Linked Exchange Rate System ("LERS"). Mr Christopher CHEUNG asked whether HKMA would, apart from buying HKD when the weak-side Convertibility Undertaking was triggered, consider raising HKD's interest rates to tackle capital outflow.

22. CE/HKMA explained that under LERS, HKMA would not actively manage local interest rates, which were instead determined passively by capital flows. HKD interest rates had remained low amid abundant liquidity in the banking system, as some US\$130 billion had been flown into Hong Kong since 2008. With several hikes of USD interest rates, there had been increasing interest arbitrage activities, leading to an outflow from HKD and a contraction of the Monetary Base, which would eventually cause HKD interest rates to rise.

Development of financial technologies

23. Mr CHAN Chun-ying pointed out that while the "Banking Made Easy" ("BME") initiative launched by HKMA and WeBank (an Internet bank in the Mainland) relied on the use of big data and facial identification to handle certain banking services, the underlying big data collection ecosystem of Hong Kong was significantly different from that of the Mainland. He was concerned how BME could achieve its objectives. Mr Christopher CHEUNG raised similar concerns.

24. CE/HKMA said that under BME initiative, banks could use new technologies (e.g. big data and facial recognition) in various operations including remote onboarding. DCE(B)/HKMA added that while there were stringent

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requirements under the Personal Data (Privacy) Ordinance (Cap. 486) on the use of personal data, banks could still use the data provided by their customers (e.g. income, expenses, debts and credit card spending patterns) to conduct relevant analyses in order to enhance customers' experience. The banking industry generally welcomed BME.

25. Mr Charles Peter MOK expressed concern about the difficulty encountered by local technology companies in obtaining virtual bank licences, and as a result most licences would end up in the hands of Mainland banks and technology companies which had substantial experience in operating virtual banks. While expressing support for the initiative of virtual bank, Mr Holden CHOW cautioned that HKMA should not overlook the demand of the grassroots and the elderly for physical bank branches.

26. Mr Christopher CHEUNG welcomed the initiative to allow local securities firms to participate in the distribution of Silver Bonds in 2018. He enquired whether virtual banks could carry out "regulated activities" as defined under the Securities and Futures Ordinance (Cap. 571) ("SFO"). He was concerned that local securities firms and virtual banks were not operating on a level playing field as virtual banks could provide loans to investors with relatively low interest rates and local securities firms were required to meet more stringent regulatory requirements in the provision of information under SFO.

27. CE/HKMA said that since HKMA announced the review of the Guideline on Authorization of Virtual Banks ("Guideline"), a number of local and overseas firms had expressed interest in applying for the virtual bank licences. The HKMA aimed to publish the revised Guideline soon, and welcomed both local and overseas firms (whether banks or technology companies) to submit applications. HKMA would adopt a risk-based approach in regulating virtual banks. In addition to the capital requirements applicable to all banks under the Banking Ordinance (Cap. 155), HKMA would consider a host of factors in vetting applications for virtual bank licences, including whether the applicants would promote financial innovation, better customer experience and financial inclusion. DCE(B)/HKMA added that one of the key objectives of introducing virtual banks in Hong Kong was to promote financial inclusion, rather than reducing the physical branches of conventional banks. In fact, some conventional banks indicated to HKMA that they appreciated the need to maintain physical branches to serve the people in need. DCE(B)/HKMA assured members that HKMA would continue to attach great importance to financial inclusion.

28. Regarding the business to be conducted by virtual banks, CE/HKMA said that virtual banks would be allowed to provide various banking services including dealing in securities for their customers. DCE(B)/HKMA added that same as

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conventional banks, virtual banks that intended to engage in securities business were required to obtain licence from SFC. It was hoped that introducing virtual banking would enhance customer experience in banking services.

29. Mr CHAN Chun-ying enquired about HKMA's measures to attract participants of its Fintech Career Accelerator Scheme ("FCAS 2.0") to stay in Hong Kong and develop their careers. CE/HKMA advised that FCAS 2.0 provided training and internship opportunities for participants to acquire more practical experience. As banks in Hong Kong had been actively launching financial technologies ("Fintech") products and services, there had been more Fintech-related jobs in the market. He believed that Hong Kong had its competitive edge to attract and retain the talents.

30. In response to Mr CHAN Chun-ying's enquiry about publicity of and investor education for the Faster Payment System ("FPS") which would be launched in September 2018, DCE(D)/HKMA advised that both HKMA and the banking industry would be involved in the publicity work. HKMA would take the lead in launching a publicity campaign to introduce the key features and benefits of FPS to the public, while individual banks could promote their own FPS-related products and services.

Cross-border payment and banking services between Hong Kong and the Mainland

31. Mr CHAN Kin-por enquired whether implementation of FPS would facilitate Hong Kong people in using the major retail payment systems in the Mainland. He also enquired about the timetable for establishing a cross-border payment system between Hong Kong and the Mainland.

32. Ms Starry LEE expressed disappointment about the slow progress in the development of electronic payment systems in Hong Kong, and called on HKMA to step up its work in promoting cross-border payment between Hong Kong and the Mainland. She further relayed Democratic Alliance for the Betterment and Progress of Hong Kong's suggestions for the Administration and HKMA to consider: (a) launching a pilot scheme to enable Hong Kong people to open bank accounts in the Bay Area by using their residential addresses in Hong Kong (instead of residential addresses in the Mainland); (b) formulating measures to allow remote onboarding of Mainland bank accounts in Hong Kong; and (c) implementing measures to facilitate Hong Kong people in using the major retail payment systems in the Mainland.

33. CE/HKMA clarified that FPS was established for use within Hong Kong. HKMA noted the desire of Hong Kong people to be able to use Hong Kong

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e-wallets in the Mainland, especially in the Bay Area, and that some operators of stored value facilities were developing cross-border payment systems for this purpose. As it was necessary to obtain approval of the relevant Mainland authorities on such systems, it was difficult to provide a concrete implementation timetable at the moment. At the same time, HKMA was discussing with the People's Bank of China on the feasibility of allowing Hong Kong people to use their Hong Kong residential addresses for opening accounts (including remote onboarding) in the Bay Area. Currently, Mainland people could use their residential addresses in the Mainland for opening bank accounts in Hong Kong. It was envisaged that the soon-to-be-promulgated Bay Area Development Plan would include measures to foster the flow of people and capital in the Bay Area.

Mortgage loans for residential properties

34. Mr Holden CHOW noted that the average loan-to-value ("LTV") ratio for new residential mortgage loans was on a downward trend since 2009. He was concerned that due to the existing stringent LTV ratio caps for residential mortgages, genuine home buyers had to arrange top-up loans with property developers or other lending institutions, and this might adversely affect their debt-servicing ability in the long run. He asked if HKMA would consider relaxing the LTV ratio caps.

35. DCE(B)/HKMA advised that HKMA had implemented eight rounds of countercyclical macroprudential measures with the aim to enhance the resilience of banks and mortgage borrowers against any possible downturn in the local property market. HKMA fully appreciated the potential impact of the measures on genuine home buyers, and had therefore introduced other measures to mitigate the impact, including allowing banks to provide mortgage loans with a higher LTV ratio for eligible borrowers under HKMC's Mortgage Insurance Programme. He undertook to provide supplementary information on such measures.

(Post-meeting note: HKMA's supplementary information was circulated to members vide LC Paper No. CB(1)1103/17-18(02) on 11 June 2018.)

Regulation of cryptocurrencies and initial coin offerings

36. Mr Charles Peter MOK highlighted latest developments in the regulation of cryptocurrencies and initial coin offerings ("ICO") in other jurisdictions including Switzerland, Japan and Korea. He called on HKMA and FSTB to take proactive actions in formulating Hong Kong's regulatory regime for cryptocurrencies and ICO. Mr Dennis KWOK enquired if HKMA and FSTB had any plan to review the regulation on cryptocurrencies making reference to international developments including G20's call for the international

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standard-setting bodies to formulate relevant regulation by July 2018 and the People's Bank of China's study on creating its own cryptocurrencies.

37. CE/HKMA said that the international financial community in general adopted a prudent attitude towards cryptocurrencies given their anonymous nature and the lack of intrinsic value. HKMA had been reminding banks about the anti-money laundering and counter-terrorist financing ("AML/CTF") requirements when handling transactions involving cryptocurrencies, and hence banks had been handling these transactions prudently. DCE(D)/HKMA added that while currently there was no legislation prohibiting the trading of cryptocurrencies in Hong Kong, HKMA had stressed to banks the need to comply with the statutory AML/CTF requirements in handling transactions involving cryptocurrencies. Separately, on central bank digital currencies ("CBDC"), HKMA had embarked on a study in this area and would continue to work with other central banks to look into the implications of CBDC. He pointed out that owing to different circumstances, the demand for CBDC as a means of payment varied in different jurisdictions. HKMA would consider this matter carefully.

38. Pointing out that the Financial Action Task Force ("FATF") had raised concern about the money laundering risks arising from human trafficking, Mr Dennis KWOK expressed concern about inadequacy of the existing regulatory regime on human trafficking and urged HKMA to tackle the issue including examining the need of imposing requirements on banks to monitor transactions/accounts that might involve human trafficking. The Chairman enquired whether the Administration had addressed the issue in Hong Kong's Money Laundering and Terrorist Financing Risk Assessment Report ("the Assessment Report") released in April 2018.

39. DCE(B)/HKMA advised that a legal framework was currently in place to combat human trafficking crimes, and the issue of money laundering threats arising from human trafficking was addressed in paragraph 5.2.15 of the Assessment Report. The banking industry was aware of the issue. Under relevant existing legislation, money flows arising from human trafficking activities would be regarded as money laundering activities, and banks were required to monitor and report these suspicious activities. He further remarked that FATF would conduct a mutual evaluation on Hong Kong's AML/CTF regime in late 2018.

Performance of the Exchange Fund

40. Mr CHAN Kin-por enquired about the reasons for the investment loss in the category "Other equities" of EF in the first quarter of 2018, and opined that HKMA should provide quarter-to-quarter comparison of EF's investment

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performance in future briefings to facilitate LegCo Members in understanding the situations.

41. CE/HKMA explained that the investment loss concerned was attributable to a decline in the global stock markets from their record highs since late January 2018 triggered by market concerns on rising inflationary pressure in the US and trade conflicts between the US and China. He agreed to provide a comparison of EF's investment income in the first quarter of 2017 and 2018 but cautioned that a direct comparison of EF's quarterly investment returns might not be appropriate given that EF's performance primarily reflected mark-to-market changes in the fair value of its assets which were easily affected by the volatility of the global financial markets.

(Post-meeting note: HKMA's supplementary information was circulated to members vide LC Paper No. CB(1)1103/17-18(02) on 11 June 2018.)

The Life Annuity Scheme administered by the Hong Kong Mortgage Corporation

42. Mr WONG Ting-kwong enquired if HKMA would consider increasing the proposed issuance amount and the cap of premium amount (which stood at HK\$ 10 billion and HK\$ one million respectively) for LAS if the market feedback was positive, and how HKMA would handle oversubscription of LAS.

43. CE/HKMA advised that should there be overwhelming demand for the first batch of LAS, HKMC would consider the feasibility of increasing the issuance amount without compromising the risk management considerations. DCE(M)/HKMA added that in terms of the cap of premium amount for each subscriber, HKMC was inclined to maintain the cap level owing to the risk management considerations and in order to accommodate more subscribers under LAS.

VI Proposed amendments to the Securities and Futures (Professional Investor) Rules

(LC Paper No. CB(1)926/17-18(06) — Administration's paper on "Proposed amendments to standardise the rules for prescribing professional investors in Hong Kong")

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Briefing by the Administration

44. At the invitation of the Chairman, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)¹ briefed members on the background of the amendments proposed by SFC to standardize the Securities and Futures (Professional Investor) Rules (Cap. 571D) ("the PI Rules") for prescribing certain categories of professional investors. The proposed amendments were subject to the negative vetting procedure of LegCo. She emphasized that upon implementation of the proposals, intermediaries would still be subject to the suitability requirement and other fundamental requirements as stipulated by SFC when serving professional investors, and hence the proposals would not undermine the essential protection for investors.

45. The Senior Director (Intermediaries Supervision, Intermediaries), Securities and Futures Commission ("SD/SFC") briefed members on the details of the proposed amendments to the PI Rules. He said that the proposed amendments would fall under three areas, namely (a) allowing the aggregation of certain assets by individuals towards meeting the portfolio threshold to qualify as professional investors, (b) expanding the definition of corporations as professional investors, and (c) allowing the use of alternative forms of evidence to demonstrate qualification as professional investors.

Discussion

46. Mr CHAN Chun-ying expressed support for the proposals. He noted that SFC had granted around 40 modifications to improve operational efficiency of the PI Rules on request by intermediaries and sought information on the businesses of such intermediaries concerned. He enquired about the details of enquiries intermediaries were expected to make in deciding an individual's share of a portfolio held in a joint account with non-associates when determining whether the individual met the threshold as a professional investor. Noting that SFC conducted a soft consultation from December 2015 to June 2016, he asked if SFC had further liaised and discussed with market participants in finalizing the present proposals.

47. SD/SFC advised that the modifications had been made mainly upon requests from banks and securities firms. As regards consultation on the proposed amendments to the PI Rules, he said that after the soft consultation, SFC had issued a public consultation paper on the proposed amendments to the PI Rules on 1 March 2017 to gauge views from market participants and interested parties. The Department of Justice also helped vetting the proposed amendments. On the actions intermediaries should take in ascertaining whether an investor met the monetary thresholds as a professional investor under the PI Rules, he said that

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according to the Code of Conduct for Persons Licensed by or Registered with SFC ("Code of Conduct"), a licensed or registered person should take all reasonable steps to establish a client's financial situation. Intermediaries could apply the reasonable steps as appropriate including making enquiries or requiring a client to fill in a questionnaire regarding his financial situation, etc., to determine an individual's share of a portfolio held in a joint account with non-associates when determining whether the individual could meet the threshold as a professional investor.

48. Mr CHAN Kin-por supported standardizing the rules for prescribing professional investors, and called on the Administration to strengthen investor education with a view to enhancing investors' understanding of the rights and obligations of professional investors. SD/SFC responded that professional investors were allowed to participate in private placement activities and according to the Code of Conduct, intermediaries should remind professional investors of the risks involved. SFC would continue to cooperate with the Investor Education Centre in strengthening investor education in this regard.

49. Mr Holden CHOW noted that intermediaries could dis-apply certain requirements when they served professional investors as the latter were considered to be more sophisticated investors and could better protect themselves. As more people would qualify as professional investors upon implementation of the proposals, Mr CHOW asked if SFC would conduct regular review of the professional investors regime to ensure its healthy development. Regarding the proposal to expand the definition of corporations as professional investors to include a corporation if its principal business was investment holding, Mr CHOW enquired about the details on "principal business", and whether there would be any specific timeframe set for holding investments as a corporation's principal business.

50. SD/SFC responded that SFC would conduct on-site inspections to intermediaries on a continuous basis to ensure their compliance with the relevant regulatory requirements, and had been undertaking regular reviews of the PI Rules since its first promulgation in 2003. He said that no timeframe would be imposed on the requirement of "principal business" of a corporation. Under the proposed amendments, a corporation would qualify as a professional investor if its principal business was investment holding at the relevant date on which the offer was made and was wholly owned by one or more professional investors.

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VII Tax deductions for deferred annuity premium and Mandatory Provident Fund voluntary contribution

(LC Paper No. CB(1)926/17-18(07) — Administration's paper on "Tax deductions for deferred annuity premium and Mandatory Provident Fund voluntary contribution")

Briefing by the Administration

51. At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Financial Services)2 ("DS(FS)2") briefed members on the background, policy considerations and proposed implementation details for introducing tax deduction for taxpayers who made Mandatory Provident Fund voluntary contribution ("MPF VC") or took out a deferred annuity. DS(FS)2 said that to enjoy the proposed tax deduction in relation to MPF VC, scheme members must put MPF VC in a new separate Tax Deductible Voluntary Contribution ("TVC") account and all existing MPF mandatory contribution ("MPF MC") preservation requirements would apply to the accrued benefits in the TVC account. Employees, self-employed persons, scheme members of MPF-exempted Occupational Retirement Schemes could open TVC accounts with any MPF trustees of their choice. As regards deferred annuity, DS(FS)2 said that premiums paid for deferred annuity products would be eligible for tax deduction if such products could satisfy the criteria set out in the guidelines to be issued by the Insurance Authority ("IA"). The proposed eligibility criteria included a minimum total premium of \$180,000 and a minimum payment period of five years, a minimum annuity period of 10 years, annuitization at the age of 50 or beyond, and certain disclosure requirements. A taxpayer might claim tax deduction for MPF VC and deferred annuity premiums in aggregate up to the maximum limit of \$36,000 per year. The Government planned to introduce the relevant amendment bill into LegCo in the last quarter of 2018. Subject to the passage of the bill, the proposed deduction would be effective from the year of assessment of 2019/2020.

(Post-meeting note: The powerpoint presentation materials (LC Paper No. CB(1)967/17-18(03)) were issued to Members vide Lotus Notes e-mail on 16 May 2018.)

Discussion

52. Mr Holden CHOW and Mr CHAN Kin-por welcomed the proposal to provide tax concession to deferred annuity products' premiums and MPF VC so as

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to encourage people to better prepare for their retirement. They considered that the proposed maximum tax deductible limit of \$36,000 per year was too low and called on the Administration to increase the amount to enhance the incentive for taxpayers to purchase deferred annuities and/or make MPF VC for their retirement. Mr CHAN further suggested raising the maximum tax deductible limit to \$60,000 per year and doubling the amount if the annuity also covered the policy holder's spouse.

53. Mr CHAN Kin-por referred to the submission from the Hong Kong Federation of Insurers (i.e. LC paper no. CB(1)968/17-18(01) and highlighted the suggestions of the insurance industry on the Administration's proposal on tax deduction for deferred annuity premium which included (a) setting the minimum premium payment period at three years; (b) adjusting the percentage of guaranteed portion of pay-outs according to the accumulation period and the annuity period; and (c) raising the maximum tax deductible limit.

54. DS(FS)2 took note of the views and suggestions put forward by members and said that the Government would consider adjusting the maximum tax deductible limit. He said that IA would further discuss with insurers in finalizing the eligibility criteria for deferred annuity products. He said that the finalized criteria had to ensure that eligible products served the purpose of retirement planning and there was adequate protection for the policy holders.

55. Mr Holden CHOW enquired how IA would handle disputes between the insurance intermediaries and policy holders of deferred annuity products in the future besides closely monitoring the sales process of intermediaries, and whether IA would consider providing mediation services in resolving the disputes. Furthermore, he pointed out that the high management fees charged by MPF trustees remained a problem and stressed the need for the Administration to keep on reviewing and refining the MPF system.

56. DS(FS)2 advised that IA would issue guidelines specifying detailed requirements, including disclosure requirements, of the deferred annuity products to facilitate members of the public to make informed decisions. Moreover, IA would implement the new licensing regime for insurance intermediaries in mid-2019 which would enhance regulation of intermediaries. Executive Director (Long Term Business), Insurance Authority added that IA had an established mechanism in handling disputes between insurance intermediaries and policy holders, as well as complaints against insurance intermediaries. In addition to undertaking investigation, IA would also conduct case analysis with a view to identifying areas for improvement.

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57. As regards the fees and charges of MPF schemes, DS(FS)2 said that the Government had been implementing initiatives to reduce fees and charges of MPF schemes including rolling out the fee-controlled Default Investment Strategy ("DIS") on 1 April 2017. It was envisaged that DIS would promote competition among MPF service providers on fees and fund performance. The Government would review the fee cap under DIS within three years after its implementation.

58. Mr WU Chi-wai sought clarification on whether accrued benefits in the TVC accounts could have the same status as and enjoy the protection of MPF MC, such as the benefits would not be regarded as scheme members' assets for the purpose of applying for social assistance (e.g. Comprehensive Social Security Allowance ("CSSA")), could not be claimed by creditors in the event of bankruptcy of the scheme members, etc. He also enquired about the protection for scheme members and policy holders against default risks.

59. In response to Mr WU's first question, DS(FS)2 explained that contributions made to the TVC accounts and MPF VC were of the same nature in the sense that both would be subject to preservation requirements. The treatment of them for means-tests should be the same. He noted that the cash value of an insurance policy was considered as readily realizable assets of an applicant for CSSA means-test. An annuity was an insurance policy and therefore should be, in principle, accorded the same treatment as other insurance policies in means-tests. Protecting the accrued benefits of the scheme members or the policies' cash value of policy holders from creditors in the event of bankruptcy should be carefully considered as there was a possibility of abuse by debtors. As regards protection against default risks, DS(FS)2 said that a Compensation Fund was established for providing compensation to MPF scheme members for losses of accrued benefits that were attributable to misfeasance or illegal conduct committed by MPF trustees and other persons concerned with the administration of the MPF schemes. The Government was also preparing legislation for the establishment of a Policyholders' Protection Scheme for enhancing protection for policy holders' interests in the event of insolvency of an insurer. The proposed maximum compensation would be \$1 million per insurance policy. The Government planned to introduce the legislative proposals into LegCo as soon as possible in the 2018-2019 legislative session.

60. In response to the Chairman's enquiry, DS(FS)2 advised that there were few insolvency cases of insurers in the past, including one relating to a motor insurance company and one relating to the local subsidiaries of an Australian insurer. There were no insolvency cases involving insurers of life insurance business in the past.

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(At 12:43 pm, the Chairman ordered that the meeting be extended for 15 minutes to 1:00 pm. Members agreed.)

VIII Any other business

61. There being no other business, the meeting ended at 12:45 pm.

Council Business Division 1
Legislative Council Secretariat
26 July 2018