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Legislative Council

LC Paper No. CB(1)828/20-21
(These minutes have been seen by the Administration)

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Panel on Financial Affairs

Meeting by videoconferencing on
Monday, 1 February 2021, at 9:30 am

Members present	**:**	Hon Jeffrey LAM Kin-fung, GBS, JP (Chairman) Hon WONG Ting-kwong, GBS, JP (Deputy Chairman) Hon Abraham SHEK Lai-him, GBS, JP Hon Starry LEE Wai-king, SBS, JP Hon CHAN Kin-por, GBS, JP Hon Mrs Regina IP LAU Suk-yee, GBS, JP Hon MA Fung-kwok, GBS, JP Hon Christopher CHEUNG Wah-fung, SBS, JP Ir Dr Hon LO Wai-kwok, SBS, MH, JP Dr Hon Junius HO Kwan-yiu, JP Hon Holden CHOW Ho-ding Hon SHIU Ka-fai, JP Hon CHAN Chun-ying, JP Hon CHEUNG Kwok-kwan, JP Hon LUK Chung-hung, JP Hon Kenneth LAU Ip-keung, BBS, MH, JP Dr Hon CHENG Chung-tai
Public officers attending	**:**	<u>Agenda Item III</u> Mr Eddie YUE, JP Chief Executive Hong Kong Monetary Authority Mr Arthur YUEN, JP Deputy Chief Executive (Banking) Hong Kong Monetary Authority

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

Mr Edmond LAU, JP
Senior Executive Director (Development)
Hong Kong Monetary Authority

Agenda Item IV

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

Agenda Item V

Mr Christopher HUI, JP
Secretary for Financial Services and the Treasury

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

Ms Estrella CHEUNG
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)1

Ms Marianna YU
Registry Manager
Companies Registry

Mr Kenneth HUI
Head (Market Development)
Hong Kong Monetary Authority

Attendance by invitation : Agenda Item IV

Mr Tim LUI, SBS, JP
Chairman
Securities and Futures Commission

Mr Ashley ALDER, SBS, JP
Chief Executive Officer
Securities and Futures Commission

Mr Andrew WAN
Chief Financial Officer and Senior Director of Corporate Affairs
Securities and Futures Commission

Mr Paul YEUNG
Commission Secretary and Senior Director
Securities and Futures Commission

Agenda Item V

Ms Grace CHAN
Director (Investment Products Division)
Securities and Futures Commission

Ms Elizabeth WONG
Associate Director (Investment Products Division)
Securities and Futures Commission

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

Staff in attendance : Miss Sharon LO
Senior Council Secretary (1)9

Ms Sharon CHAN
Legislative Assistant (1)4

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I Information paper issued since the meeting on 4 January 2021

(LC Paper No. CB(1)500/20-21(01) — Third quarterly report of 2020 on "Employees Compensation Insurance — Reinsurance Coverage for Terrorism")

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Members noted the information paper issued since the regular meeting held on 4 January 2021.

II Date of next meeting and items for discussion

(LC Paper No. CB(1)533/20-21(01) — List of outstanding items for discussion

LC Paper No. CB(1)533/20-21(02) — List of follow-up actions)

2. Members agreed to discuss the following items proposed by the Administration at the regular meeting scheduled for 1 March 2021, at 9:30 am:

(a) Budget of the Mandatory Provident Fund Schemes Authority for the financial year 2021-2022;

(b) Budget of the Insurance Authority for the financial year 2021-2022;

(c) Budget of the Financial Reporting Council for the financial year 2021-2022; and

(d) Rules on contractual stays on termination rights in financial contracts for banks under the Financial Institutions (Resolution) Ordinance (Cap. 628).

III Briefing on the work of Hong Kong Monetary Authority

(LC Paper No. CB(1)533/20-21(03) — Paper provided by the Hong Kong Monetary Authority)

Briefing by the Hong Kong Monetary Authority

3. 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 Senior Executive Director (Development), Hong Kong Monetary Authority ("SED(D)/HKMA") updated members on the work of the Hong Kong Monetary Authority ("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 measures implemented by the Hong Kong Mortgage Corporation ("HKMC").

(*Post-meeting note*: The powerpoint presentation materials (LC Paper No. CB(1)540/20-21(01)) were issued to Members vide Lotus Notes e-mail on 1 February 2021.)

Discussion

Macroeconomic conditions and the financial and monetary stability of Hong Kong

4. Mrs Regina IP referred to the recent reports of some foreign media about financial regulators in Hong Kong raising questions with some overseas companies on their moves to relocate out of Hong Kong. She stressed that HKMA should step up its efforts in explaining to the international community that free capital flow and judicial independence in Hong Kong remained intact after the Central Government's enactment of the national security law in Hong Kong. The Chairman shared Mrs IP's view that HKMA should actively dispel market rumours that might undermine financial stability in Hong Kong.

5. CE/HKMA responded that HKMA had been communicating with both local and foreign media to disseminate data and information on Hong Kong. In the past few months, HKMA also proactively reached out to almost 10 000 international investors through various channels such as webinars to directly explain Hong Kong's situation, such as capital flows and impact of the national security law, through facts and figures. Going forward, HKMA would continue its outreach activities to different stakeholders in the financial community to address international investors' concern.

6. Mr WONG Ting-kwong sought HKMA's assessment of the impact of the quantitative easing ("QE") measures implemented/planned by the United States ("US") on the global and Hong Kong's financial markets, and the trend of movement in Hong Kong dollar ("HKD").

7. DCE(M)/HKMA advised that given the dominance of the US dollar in the global economy and financial system, QE measures introduced by the US would inevitably have a bearing on the global markets. Investors' search for yield behaviour driven by the low interest rate environment and abundant liquidity had fueled rallies in equity markets around the world including Hong Kong. Over the past year, Hong Kong's equity market continued to experience inflows, mainly due to the large number of newly listed companies. Moreover, as the Stock

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Connect schemes became more mature, more capital had been flowing into Hong Kong. HKMA would continue to closely monitor financial market developments and safeguard financial stability. On HKD, DCE(M)/HKMA emphasised the importance of the Linked Exchange Rate System ("LERS"), which had operated smoothly over the past 30 some years through ups and downs. Under LERS, HKD would only fluctuate within a narrow range between the strong-side Convertibility Undertaking ("CU") and the weak-side CU. As such, even if the US were to launch further rounds of QE, HKD fluctuation would remain limited. This underpinned the importance of LERS for externally-oriented and open economies such as Hong Kong.

8. In response to Dr Junius HO's enquiry about a projected growth of 4.7% in Hong Kong's real gross domestic product ("GDP") in 2021 (as set out on page 4 of HKMA's paper) which he considered an optimistic forecast, SED(D)/HKMA explained that the forecast took into account factors that were conducive to potential economic recovery, such as the availability of the coronavirus disease 2019 ("COVID-19") vaccines. Furthermore, the figure was based on an exceptionally low base in 2020.

9. Mr SHIU Ka-fai asked whether HKMA had assessed the impact of a potential emigration tide on Hong Kong's financial stability. DCE(M)/HKMA responded that it would be difficult to accurately estimate the number of emigrants at this juncture. In fact, capital constantly moved in and out of Hong Kong at all times. The important thing to note was that Hong Kong's financial system remained strong and robust, and LERS continued to be resilient even to significant capital flows.

10. At the request of Mr Holden CHOW and Mr LUK Chung-hung, HKMA undertook to provide information on the impact of COVID-19 pandemic and recent economic downturn on Hong Kong's household debt and its various components (including whether there was a surge in the number and amount of loan applications arising from unemployment, the amount of unsecured private loans, as well as the bad-loan ratio).

> (*Post-meeting note:* HKMA's supplementary information was circulated to members vide LC Paper No. CB(1)617/20-21(02) on 24 February 2021.)

11. At the request of Mr Kenneth LAU, HKMA undertook to provide information on the number of banks and fund companies ceasing operation in Hong Kong in the past few years, and the reasons behind.

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(*Post-meeting note:* HKMA's supplementary information was circulated to members vide LC Paper No. CB(1)617/20-21(02) on 24 February 2021.)

Measures to help the public and local enterprises combat the coronavirus disease 2019

12. Ir Dr LO Wai-kwok expressed concern about a dim outlook for the Hong Kong economy amidst the significant contraction in GDP in 2020 and the high unemployment rate. Noting that many small and medium-sized enterprises ("SMEs") were still facing a very challenging operating environment, he enquired if HKMA would introduce further measures to help SMEs.

13. Mr CHAN Chun-ying noted that HKMA might consider extending the Pre-approved Principal Payment Holiday Scheme ("PPPHS") and the principal moratorium arrangement for the 80% and 90% Guarantee Products under the Enhanced SME Financing Guarantee Scheme ("Enhanced SFGS"), and enquired about the progress of discussions with the banking sector on the matter.

14. In view of Hong Kong's existing economic challenges, Mr SHIU Ka-fai shared the view that HKMA should consider extending PPPHS further, and extending the repayment schedules of the Special 100% Loan Guarantee Scheme under the Enhanced SFGS from three years to five years.

15. The Chairman said that while the business sector welcomed the 90-day repayment deferment for trade facilities under PPPHS, he opined that HKMA should announce this measure at an earlier time. As the COVID-19 pandemic might not subside in the short run, he stressed the importance for the Administration to expedite the approval process of relevant vaccines which would pave the way for a swift recovery of the Hong Kong economy. Given that it would take a long time for the business of many enterprises (particularly SMEs) to return to the pre COVID-19 level, the Chairman called on HKMA to continue urging banks to adopt a more accommodating attitude in considering extension of borrowers' repayment schedules.

16. CE/HKMA noted the expectation for HKMA to support the economy (particularly SMEs) during this difficult period amid the COVID-19 pandemic. DCE(M)/HKMA said that the existing support measures under the Enhanced SFGS continued to be reviewed to meet SMEs' needs. DCE(B)/HKMA added that HKMA would liaise with the banking industry on the way forward of PPPHS, but noted that it would also be important to strike an appropriate balance between supporting the economy and upholding banks' sound risk management. He further clarified that although PPPHS was due to expire in April 2021, the principal payment of PPPHS applicants would not necessarily fall due at that

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time, as the payment would be due six months after their application for extension.

17. Noting that both the credit card charge-off ratio and the ratio of overdue and rescheduled loans had increased in the third quarter of 2020, Mr Holden CHOW enquired whether HKMA would discuss with the banking sector on implementing relevant relief measures to help the borrowers concerned.

18. DCE(B)/HKMA advised that HKMA had asked the banking industry to introduce measures to help relieve cash-flow pressure of corporate/SME/retail customers. Banks had launched relevant measures including principal repayment holidays to help customers ride out the COVID-19 pandemic.

19. Dr CHENG Chung-tai requested HKMA to provide further information on various schemes launched by HKMA and the banking industry to help the public and enterprises to tide over challenges arising from the COVID-19 pandemic (e.g. PPPHS and the Enhanced SFGS), including the amount of loans made under individual schemes in the past few quarters and HKMA's observations on the utilization of such schemes by applicants. Dr CHENG also expressed concern about a possible tightening in the approval criteria of the Enhanced SFGS in view of the stringent position in public finance, and whether HKMC had imposed a cap on the proportion of successful applicants who could opt for the principal moratorium option.

20. DCE(B)/HKMA undertook to provide information as requested by Dr CHENG Chung-tai. In the second half of 2020, the participation rate of PPPHS had dropped. While customers had their own consideration when deciding whether to participate in PPPHS given it was not completely costless for borrowers to defer principal repayments, this decrease in utilization rate might also reflect that corporates' financial positions had improved. In response to Dr CHENG's concern, DCE(M)/HKMA assured that the approval criteria of the Enhanced SFGS would not be affected by changes in the investment performance of EF. The aim was all along to assist SMEs in need as soon as possible through streamlined application procedures. Furthermore, eligible applicants were free to choose the principal moratorium option under the Enhanced SFGS.

(*Post-meeting note: HKMA's* supplementary information was circulated to members vide LC Paper No. CB(1)617/20-21(02) on 24 February 2021.)

21. Mr CHAN Chun-ying commended HKMA for maintaining stable performance of EF and enquired whether some of EF's investment or accumulated surplus could be distributed to the Government's fiscal reserves and/or support additional relief measures. Ir Dr LO Wai-kwok and Mr Kenneth LAU expressed

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similar views. Pointing out that the Hong Kong economy had been hit hard by the COVID-19 pandemic in an unprecedented manner, Ms Starry LEE stressed that the Administration should adopt a more innovative mindset when formulating measures to help the public tide over the challenges concerned. She asked whether HKMA could increase EF's fee payment to the Government's fiscal reserves so as to enable the Administration to launch more relief measures. Ms LEE further sought information on the amount spent by governments of other comparable jurisdictions on supporting their economies during the COVID-19 pandemic and the comparison with that of Hong Kong.

22. CE/HKMA advised that under the established arrangement, the return on the fiscal reserves placed with EF was calculated based on the average annual investment return of EF's Investment Portfolio over the past six years or the average annual yield of three-year Government Bond for the previous year subject to a minimum of zero percent, whichever was the higher. This arrangement was designed to enhance the stability of the fiscal reserves' income. On the suggestion to draw from EF's accumulated surplus, CE/HKMA noted that the Financial Secretary ("FS") had to consider this in the context of EF's key objective, which was to maintain Hong Kong's financial stability. Furthermore, given "fiscal discipline" was an essential element to upholding confidence in LERS, one had to consider the potential signal one would send to the market if funds were to be drawn from EF's accumulated surplus.

23. As regards the scale of Hong Kong's fiscal stimulus compared to other economies, CE/HKMA viewed that a direct comparison might not be appropriate due to the different monetary systems and unique circumstances of individual jurisdictions. Nevertheless, it was observed that Hong Kong's scale of fiscal stimulus was similar to that of the major developed economies, and relatively larger than that of some emerging market economies.

24. Ir Dr LO Wai-kwok considered that the Administration should consider issuing bonds to boost Hong Kong's economic recovery. Such bonds could also be attractive investment options for members of the public. The Chairman and Mr Kenneth LAU shared the view. The Chairman further pointed out that the Airport Authority Hong Kong had successfully financed its Three-Runway System Project through issuance of bonds. Mr Holden CHOW enquired whether HKMA would advise the Government to finance infrastructure projects partly through issuance of bonds under the current low interest rate environment.

25. CE/HKMA responded that, given the importance of maintaining fiscal discipline under LERS, the Government had to consider the issuance of bonds carefully, especially if proceeds were to be used for meeting day-to-day operational needs. That said, he viewed that consideration could be given to

issuing bonds to finance initiatives with clear objectives such as fostering the development of green finance in Hong Kong.

Development of the financial services market

26. Mrs Regina IP enquired about the progress of HKMA's liaison with its Mainland counterparts on allowing cross-boundary lending and the sale of Hong Kong's financial products in the Guangdong-Hong Kong-Macao Greater Bay Area ("GBA").

27. CE/HKMA said that HKMA would continue to work with the People's Bank of China ("PBoC") to facilitate more cross-boundary initiatives between Hong Kong and the Mainland. For instance, HKMA and PBoC were discussing the operational arrangements of the Wealth Management Connect scheme, which sought to allow residents in GBA to purchase Hong Kong's wealth management products. For cross-boundary lending or provision of other financial services, HKMA had also been liaising with its Mainland counterparts and hoped to announce various project deliverables in the near future as they became ready.

28. Mr WONG Ting-kwong enquired whether HKMA had analysed the substantial increase in the daily turnover of Hong Kong's stock market in recent months despite the fact that the Hong Kong economy had been hard hit by the COVID-19 pandemic, and whether HKMA had assessed the potential risks arising from the phenomenon.

29. Mr Christopher CHEUNG considered that the current buoyant market activities were caused by a number of factors including a relatively low price-to-earnings ratio of Hong Kong's stocks, the recent appreciation of renminbi, and changes in the regulatory policies of the US (which might cause a number of Chinese companies to change their listing platforms from the US to Hong Kong). He stressed that the buoyant market situations at present might be temporary. He also expressed concern about the Administration's possible plan to increase the rate of stamp duty on stock transactions, which might adversely affect Hong Kong's financial stability and LERS. Mr CHEUNG further pointed out that many stock markets (including the US, Japan and Singapore) no longer imposed stamp duty on transactions, and stressed that the Administration must consider the plan carefully. The Chairman shared Mr CHEUNG's view.

30. DCE(M)/HKMA said that the recent surge in the daily turnover of Hong Kong's stock market was attributable to a number of factors including the low interest rate environment, abundant liquidity in the global financial markets, significant increase in initial public offering ("IPO") activities, as well as continuous capital inflow into Hong Kong driven by the Southbound Stock Connect. As for the potential risks, HKMA had been closely collaborating with

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the Securities and Futures Commission ("SFC") to monitor market developments carefully. As for whether the stamp duty rate should be raised in the upcoming Budget, CE/HKMA noted members' views and would refer them to FS and the Financial Services and the Treasury Bureau for consideration. He also pointed out that changes in stock market transaction volumes would unlikely have substantial impact on LERS.

31. In response to Mrs Regina IP's enquiry about whether the Administration had any plans to develop virtual currency in Hong Kong, SED(D)/HKMA advised that there was already a regulatory regime in place for virtual asset exchanges that facilitated trading in security tokens. He added that the Administration had recently proposed to introduce a new licensing regime for virtual asset services providers.

The property market

32. Mr CHAN Kin-por noted with concern that Hong Kong's household debt to GDP ratio had increased from 54.3% in 2005 to 87.7% in the third quarter of 2020. He enquired whether HKMA would take measures to address this rising trend. Echoing Mr CHAN's concern, Dr Junius HO enquired if there was a target level of Hong Kong's household debt to GDP ratio set by HKMA, and whether HKMA had conducted analyses on the surge in the ratio over the past few years.

33. CE/HKMA said that changes in the household debt-to-GDP ratio depended on both the debt and GDP levels. The recent increase in the ratio was attributable to an increase in mortgage loans and a decline in Hong Kong's nominal GDP. He added that, although the household debt-to-GDP ratio had been widely used as an indicator to evaluate households' financial position, a full assessment required the consideration of the entire household balance sheet, including the amount of assets and the composition of assets and liabilities. From this perspective, Hong Kong's household net worth-to-liabilities ratio remained high by international standard. CE/HKMA further pointed out that HKMA had been requiring banks to manage risks prudently, and would continue to monitor market development closely. CE/HKMA undertook to provide information as requested by Dr Junius HO.

> (*Post-meeting note: HKMA's* supplementary information was circulated to members vide LC Paper No. CB(1)617/20-21(02) on 24 February 2021.)

34. Mr CHAN Kin-por asked whether loans classified as "loans for other private purposes" mainly consisted of unsecured loans. On residential mortgage loans, noting the continuous decline in both average loan-to-value ("LTV") ratio and average debt servicing ratio ("DSR") from 2010 to 2020, Mr CHAN enquired

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whether this trend, coupled with the steady increase in household debt classified as "loans for other private purposes" during the same period, implied that more and more property buyers had difficulties in taking up mortgage loans and thus, had to rely on private loans which were subject to higher interest rates; and if so, how HKMA would tackle the issue.

35. DCE(B)/HKMA advised that household debt classified as "loans for other private purposes" were mostly secured loans obtained by bank customers using their financial assets as collateral for wealth management and investment purposes. He also explained that the decrease in the average LTV ratio and average DSR was attributable to HKMA's introduction of countercyclical macroprudential measures for property mortgage loans over the years. Despite the fact that both ratios had risen somewhat in recent years, HKMA still considered the relevant risk manageable.

The Linked Exchange Rate System and the Exchange Fund

36. Pointing out that the US dollar weakened against most currencies after the launch of several rounds of QE in the US, Mr LUK Chung-hung enquired whether HKMA had conducted any studies on the feasibility of pegging HKD to a basket of currencies.

37. CE/HKMA stressed that LERS was undoubtedly the most suitable regime for Hong Kong as an externally-oriented economy, and HKMA did not intend, nor did it see any need, to change the regime. Moreover, CE/HKMA pointed out that in other currency arrangements such as pegging to a basket of currencies, interest rates would still largely follow that of the US since the US dollar would still likely account for a large proportion in the basket. Furthermore, there would likely be practical difficulties and drawbacks to pegging to a basket of currencies.

38. Pointing out that EF's investment in alternative assets held under the Long-Term Growth Portfolio ("LTGP") had been gaining relatively high annualized internal rate of return in recent years, Mr CHAN Chun-ying enquired whether HKMA would consider increasing the size of LTGP in EF's Investment Portfolio, with a view to raising EF's investment income and fee payment to the Government's fiscal reserves so as to roll out more relief measures for businesses and individuals in Hong Kong.

39. CE/HKMA explained that the size of LTGP in EF's Investment Portfolio had been capped at the aggregate of one-third of EF's accumulated surplus and the portion of Future Fund and placements by EF's subsidiaries linked to LTGP to ensure EF had sufficient liquidity. That said, there was still room to raise LTGP's size in EF's Investment Portfolio.

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Annuity Plan of the Hong Kong Mortgage Corporation

40. Mr LUK Chung-hung enquired about the enhancement measures HKMC would take for its Annuity Plan ("AP"), including whether HKMC would consider lowering the minimum eligible age for AP.

41. DCE(M)/HKMA advised that HKMC's primary focus at this juncture was to provide an immediate AP. But HKMC would review areas for potential further enhancements to the current plan and adopt an open attitude towards whether there was room for expansion of the programme in the future.

Assistance for the clients of Messrs. Wong, Fung & Co.

42. Referring to the Law Society of Hong Kong's recent intervention into the practice of Messrs. Wong, Fung & Co. which had misappropriated its clients' money, Ms Starry LEE enquired if HKMA would take measures to help those clients of the firm whose property transactions were handled by the firm and affected by the incident.

43. DCE(B)/HKMA advised that HKMA had already contacted relevant banks and requested them to provide suitable assistance to facilitate the timely completion of affected transactions. Banks had proactively contacted relevant customers to offer help. HKMA had also followed up on cases. Meanwhile, HKMA had been discussing with the Law Society of Hong Kong as well as The Hong Kong Association of Banks to explore ways to improve the handling of such cases should they happen again in the future.

IV Budget of the Securities and Futures Commission for the financial year 2021-2022

(LC Paper No. CB(1)533/20-21(04) — Administration's paper on "Securities and Futures Commission - Budget for the Financial Year 2021-2022"

LC Paper No. CB(1)533/20-21(05) — Updated background brief on the annual budgets of the Securities and Futures Commission prepared by the Legislative Council Secretariat)

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Briefing by the Administration

44. At the invitation of the Chairman, Chairman, Securities and Futures Commission ("C/SFC") briefed members on SFC proposed budget for 2021-2022. He highlighted that in view of the challenges posed by the outbreak of COVID-19, SFC had decided to continue the annual licence fee waiver for one more year in 2021-2022 so as to relieve the cost burden on the securities and futures industry. The income forgone in 2021-2022 arising from the fee waiver was estimated to be about $237 million.

45. As for the 2020-2021 budget, C/SFC said that instead of a budget deficit of about $653 million as projected previously, SFC anticipated a surplus of $153 million which was primarily generated by the higher-than-budgeted market turnover in the securities market for the first seven months of 2020-2021 (an average of $133 billion per day). For the proposed budget for 2021-2022, SFC had projected a budget deficit of $184.1 million, with estimated income and estimated recurrent expenditure of $2,035.6 million and $2,219.7 million respectively. The securities market turnover was estimated to be $123 billion per day.

46. On the estimated recurrent expenditure of $2,219.7 million for 2021-2022, C/SFC said that staff cost was the largest expenditure item amounting to about $1,518 million. Having reviewed SFC's manpower needs for 2021-2022 and in recognition of the deteriorating economic conditions, SFC would not propose any new headcount with the exception of four positions specifically created to retain the Graduate Trainees upon their successful completion of the three-year Graduate Trainee Programme with SFC. While proposing a pay freeze for 2021-2022, SFC had set aside a limited pool to address pay anomalies for selected junior support staff. On the other hand, SFC proposed a total of 32 position upgrades which were necessary to cope with the expansion of roles and responsibilities, increase in job complexity and to facilitate career progression for SFC's high-performing staff.

47. As regards office premises, C/SFC said that SFC's relocation to the new office in Quarry Bay in mid-2020 would result in an annual saving of $125 million on office rental. The sum would be contributed to the reserves of $3,125 million ring-fenced for the possible acquisition of office premises for SFC in the future. It was estimated that by end of March 2022, SFC's ring-fenced reserves would reach $3,250 million while the non-ring-fenced reserves would be $3,413 million.

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Discussion

Estimated expenditure on staff cost and external activities

48. Mr CHAN Chun-ying welcomed SFC's proposal to freeze headcount and staff salaries in 2021-2022. He noted that there would be 32 position upgrades and enquired about the details and whether the upgrades could lead to unnecessary expansion of certain ranks. Given that the development of COVID-19 pandemic remained uncertain in the near future, Mr CHAN asked why SFC had budgeted an increased expenditure of $10.35 million in 2021-2022 for overseas travelling of officers for engaging in regulatory and external activities.

49. C/SFC advised that the 32 position upgrades would spread across various departments of SFC. The proposed upgrades had undergone stringent examination by SFC, and principally reflected the increasing complexity and scope of the respective roles of the positions, as well as to provide career progression for high performing staff. As regards increase in expenses on regulatory and external activities, C/SFC said that SFC's expenses in overseas activities in 2020-2021 were lower than in previous years due to the suspension of overseas travelling and the deferral or cancellation of seminars throughout the COVID-19 pandemic. The expenses in 2021-2022 would be comparable to the normal levels of previous years. While the budget reflected an assumption that overseas travelling would resume in 2021-2022, there were still uncertainties and therefore the actual expenses under this item would depend on how the COVID-19 pandemic would evolve.

Estimated income

50. Mr CHAN Chun-ying enquired about the reasons for SFC projecting an income of $2,035.6 million for 2021-2022, which was 13.8% lower than the forecast income for 2020-2021, and whether it had taken into account all relevant factors in making the projection, especially the surge in the turnover in the securities market in recent months and the impact of a possible increase in the rate of stamp duty on stock transactions on market turnover.

51. C/SFC advised that the estimated income of $2,035.6 million for 2021-2022 was $325.14 million below the forecast income for 2020-2021. The assumptions adopted for the estimated income for 2021-2022 included the securities market turnover, income forgone of $237 million due to the annual licensing wavier, and SFC's investment income of $122.18 million which was lower than the level in the 2020-2021 budget. In respect of the securities market turnover, the estimate was an average of $123 billion per day (as compared to the average of $126 billion per day for 2020-2021) and an average of

457 000 futures/options contracts per day (the same level as that for 2020-2021). The estimated income for 2021-2022 had taken into account the latest securities market turnover (i.e. around $133 billion per day in the first seven months of 2020-2021).

52. Mr Christopher CHEUNG welcomed SFC's decision to waive the annual licensing fee, and freeze the headcount and staff salaries in 2021-2022. Noting that there were voices proposing an increase of the stamp duty rate, he expressed concern that the increase would have negative impact on the securities market and might cause foreign funds to leave Hong Kong, thus resulting in drop in market turnover and in turn would adversely affect SFC's income. He also enquired whether SFC would consider increasing the rates for investor levies on securities transactions and futures/options contracts.

53. C/SFC advised that the stamp duty and SFC's levies both constituted part of the transaction costs. Trading activities were driven by a combination of factors, including the price of stocks, as well as fairness, transparency and stability of the market, etc. Transaction cost was only one of the many factors. At the request of the Chairman and Mr Christopher CHEUNG, SFC was requested to provide supplementary information on the factors, including a possible increase of stamp duty on stock transaction that might affect investors and the volume of transactions in the market.

> (*Post-meeting note:* The supplementary information was circulated to members vide LC Paper No. CB(1)645/20-21(02) on 4 March 2021.)

Office premises

54. Mr Christopher CHEUNG urged SFC to seize the opportunity presented by the abolition of the doubled Ad Valorem Stamp Duty on non-residential properties (announced in the 2020 Policy Address) to purchase an office premises for its use. He opined that this could save rental expenses which was a major expenditure item in SFC's budget. With signs of cooling down in the heated property market, Mr WONG Ting-kwong concurred that SFC should step up its efforts in identifying a suitable office premises for purchase in order to meet SFC's operational needs and save rental expenses. Noting that the ring-fenced sum of $3,250 million in SFC's reserves might not be sufficient to purchase an office premises in one go, Mr CHAN Kin-por enquired about SFC's long-term plan in acquiring its office.

55. C/SFC said that it was the long term goal of SFC to purchase its own office premises. SFC had been monitoring developments in the non-residential property market, and had all along been proactive in its search for a property with a suitable size meeting its operational needs. SFC would also consider different

approaches in acquiring suitable office premises, such as acquiring a property already available in the market or liaising with developers for reserving suitable premises in development projects.

Regulatory work of the Securities and Futures Commission

56. Referring to the Hong Kong Exchanges and Clearing Limited ("HKEX")'s latest proposal to increase the Main Board profit requirement substantially in order to address the regulatory concerns brought by inflated valuations of small companies applying for listing, Mrs Regina IP expressed grave concern that the high listing threshold might make SMEs difficult in seeking listing. As a result, only large companies could raise funds through listing, and in turn only large financial intermediaries, such as investment banks, could provide professional services to these companies.

57. Mr Holden CHOW expressed concern that HKEX's proposal to increase the Main Board profit requirement would be inconsistent with the Government's initiatives in the 2020 Policy Address to promote IPO of pre-profit biotechnology companies. He asked how SFC would ensure the opportunity of companies, in particular SMEs, to raise funds in Hong Kong would not be compromised. He further noted that more Mainland companies would seek to change their listing venue from US to Hong Kong due to the recent sanctions imposed by the US Government on such companies.

58. Mr WONG Ting-kwong opined that SFC should examine the listing regime in detail to plug possible loopholes in cracking down shell companies instead of tightening individual listing requirements which might have negative impact on local SMEs seeking listing in Hong Kong. He shared members' views that in the face of recent sanctions imposed by the US Government on Mainland companies listed in the US, more such Mainland companies would use the Hong Kong securities market for raising funds. He enquired about measures SFC would take to attract these companies to Hong Kong.

59. On listing requirements, C/SFC and Chief Executive Officer, Securities and Futures Commission ("CEO/SFC") pointed out that while the market capitalization requirement for listing companies had been increased in 2018, there had been no adjustment in the profit requirement. HKEX's proposal to raise the profit requirement aimed to align the two listing requirements. A consultation paper had been published on the proposed changes to seek views from the public and market in November 2020, and SFC would maintain close communication with HKEX in implementing the proposed changes. As for the listing of biotechnology companies, given such companies' intensive involvement in research and development activities and their pre-profit nature, they were subject to different listing requirements when seeking listing in the Main Board. As an

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international financial centre, Hong Kong offered different funds-raising platforms for companies of various sizes. Where companies did not fulfill the profitability or track record requirements of the Main Board, they could apply for listing on the Growth Enterprise Market ("GEM"). C/SFC said that SFC was aware of views and suggestions for reforming GEM. SFC was mindful that a balance should be struck between protecting the investing public and facilitating companies to raise capital.

60. As regards SFC's regulatory work, C/SFC advised that SFC had introduced a front-loaded regulatory approach which emphasized early, targeted and systemic intervention to address persistent problems and pre-empt the fallout from emerging threats. Where serious risks which could harm investors and damage market integrity were detected, SFC would proactively seek clarifications from the companies in question. Moreover, SFC had power to halt an IPO where the companies concerned could not provide satisfactory responses to SFC's enquiries.

61. Referring to the Ant Group's earlier decision of not proceeding with its IPO, Mr WONG Ting-kwong enquired about SFC's follow up actions on the incident and whether it would take measures to prevent recurrence of similar incidents in the future.

62. C/SFC said that it was Ant Group's decision not to pursue the IPO. The refund arrangement for investors concerned was provided in the IPO prospectus. SFC noted that the refunding process was conducted in an orderly manner.

63. Mrs Regina IP noted that a number of overseas exchanges had introduced relevant requirements and regulatory measures on environmental, social and governance ("ESG") aspects of listed companies and companies seeking listing, and enquired about SFC's efforts in this respect as well as in promoting green finance.

64. CEO/SFC advised that in mid-2020, SFC and HKMA jointly initiated the establishment of the Green and Sustainable Finance Cross-Agency Steering Group ("Steering Group") with other members including HKEX and the Insurance Authority. The Steering Group aimed to coordinate regulatory policy making and market development initiatives on green and sustainable finance in Hong Kong. In late 2020, the Steering Group published a strategic plan which set out a framework to strengthen the Hong Kong financial ecosystem and leverage international collaboration to promote the development of green finance. It was believed that Hong Kong could capitalize on the opportunities in the Mainland and develop into a green finance centre. In 2021, SFC would focus on setting out developing the criteria for corporate disclosure of climate risks and developing measures to combat greenwashing around funds labelled ESG.

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65. Referring to the incidents of suspension of dividend payments by HSBC Holdings plc ("HSBC") in early 2020, and the halting of new investments by the Tracker Fund in Mainland companies listed in Hong Kong which had been sanctioned by the US government in early 2021, Mr LUK Chung-hung enquired about actions taken or planned by SFC to minimize the possible adverse impacts of measures implemented by foreign governments or regulators on the Hong Kong financial market.

66. CEO/SFC advised that since mid-2020, SFC had been in close contact with major local and US financial institutions operating in Hong Kong to ascertain how US sanctions on specific companies and individuals, and banning of US investments in some Mainland companies, would be addressed by these firms. In general, SFC noted that these firms had adopted a narrow interpretation when carrying out US sanctions. SFC had reminded them of their duties to treat clients fairly and to minimize the possible impact on the Hong Kong market. As regards the incident on the Tracker Fund, CEO/SFC replied that as soon as SFC was informed of the decision of the Tracker Fund's Manager ("the Manager") to halt new investments in US-sanctioned Mainland companies on 11 January 2021, it immediately made enquiries with the Manager. Since the Manager was a licensed corporation regulated by SFC, it had to comply with the Fund Manager Code of Conduct which prescribed certain restrictions and requirements for fund managers in relation to investment management including making adequate disclosure of information on investments. Moreover, the Supervisory Committee of the Tracker Fund, upon being informed of the Manager's decision, had sought explanations from the Manager and requested the latter to adopt measures to mitigate the impact on Tracker Fund's investors. CEO/SFC added that the US-sanctioned companies accounted for a relatively small proportion of the composition of Hang Seng Index and the Manager announced on 13 January 2021 that it would resume investment in the sanctioned companies. As regards the incident on HSBC's dividend payments, CEO/SFC said that HSBC was a UK-incorporated bank listed in Hong Kong, and was bound by the decision of its UK regulator, the Bank of England's Prudential Regulation Authority ("PRA"), to suspend dividend payments to all its shareholders. After considering the relevant rules and regulations in Hong Kong, the constitution of HSBC and the relevant rules and regulations of PRA, SFC concluded that HSBC's decision to suspend dividend payments would not be challenged by SFC from a legal and regulatory perspective. It was noted that HSBC had acknowledged that its decision had aroused controversies in Hong Kong, and also had caused distress to some of its shareholders in Hong Kong. While HSBC had a large customer base in Asia, it was entirely the Bank's decision as to whether it might domicile its headquarters in Hong Kong in future.

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67. Mr Christopher CHEUNG expressed concern about SFC's slow actions in combating investment scams despite the recent upward trend of such crimes. He said that many SME brokerage firms were of the view that SFC had not maintained impartiality in its investigation of investment scams and had seldom targeted large firms in its investigation.

68. C/SFC stressed that SFC had all along been impartial in conducting investigations of market irregularities, and acting in accordance with powers conferred to it by the Securities and Futures Ordinance (Cap. 571) ("SFO"), as well as maintaining fairness and transparency in exercising its powers. In enhancing protection for investors, SFC had stepped up its public education campaigns to remind investors to stay vigilant against investment scams. The recently launched campaign on a social media platform had featured the latest news and regulatory updates from SFC including warnings to investors about market risks, unlicensed activities and other illegal conduct of intermediaries. CEO/SFC added that SFC took investment scams, including "ramp and dump" scams, very seriously, as these accounted for about 20% of the total market manipulation cases currently under investigation by SFC. In some recent investigations, SFC had frozen the assets of investments schemes believed to be proceeds generated from scams, and executed search warrants on offices as well as domestic premises believed to be connected with suspected scams.

(*At 12:27 pm, Chairman announced that the meeting be extended to 1 pm.*)

V Re-domiciliation mechanism for foreign funds

(LC Paper No. CB(1)533/20-21(06) — Administration's paper on "Re-domiciliation mechanism for foreign funds")

Briefing by the Administration

69. At the invitation of the Chairman, Secretary for Financial Services and the Treasury ("SFST") briefed members on the legislative proposals to allow foreign investment funds to re-domicile to Hong Kong as Open-ended Fund Companies ("OFCs") or Limited Partnership Funds ("LPFs"), with a view to enhancing the attractiveness of Hong Kong's OFC and LPF regimes and the competitiveness of Hong Kong as an international asset and wealth management hub. He explained that under the proposed mechanism, a fund set up in corporate or limited partnership form under the laws of a jurisdiction outside Hong Kong was eligible to be registered as an OFC or LPF in Hong Kong respectively, if it met the same set of eligibility requirements for a new fund to be registered by SFC and the Registrar of Companies as an OFC or LPF respectively. The proposed

mechanism provided for the preservation of the continuity of the fund upon re-domiciliation and was not intended to create a new legal entity, nor affect any contract made before its registration in Hong Kong. Upon re-domiciliation, the fund would have the same rights and obligations as any other newly established OFCs or LPFs in Hong Kong, and would have to de-register in its place of incorporation/establishment. The Government planned to introduce the relevant Bills into the Legislative Council for first and second reading in the second quarter of 2021.

Discussion

70. Mr Christopher CHEUNG welcomed the proposed mechanism and tax treatment to facilitate OFCs and LPFs to re-domicile to Hong Kong. Noting that there were some suggestions from the public that the Government should increase the rate of stamp duty on stock transactions, he expressed concern that such a move would undermine the competitiveness of Hong Kong's OFC and LPF regimes and run counter to the policy objective of attracting more funds and companies to set up in Hong Kong. The Chairman shared a similar concern. He stressed that the Administration should create a business environment with legal and tax certainty to facilitate the operation of various companies so as to attract foreign investment and foreign funds to set up or re-locate to Hong Kong.

71. SFST said that the Administration was aware of members' concern about the possible impact of a stamp duty adjustment on Hong Kong's stock market as well as its status as an international financial centre. He said that the local stock market remained resilient and stable despite the volatile global market conditions and severe pandemic situations, and the daily market turnover had increased nearly by 50% in 2020 over 2019. He said that the Government would continue to examine the rate of stamp duty on stock transactions having regard to the need to strike a balance among different factors including Government revenue, market development and the competitiveness of Hong Kong's stock market.

72. Mr CHAN Chun-ying considered that any adjustment on the rate of stamp duty and main board profit requirement would have impact on the competitiveness and attractiveness of Hong Kong's financial markets. He noted that with the establishment of the OFC and LPF regimes in July 2018 and August 2020 respectively, eight OFCs and 81 LPFs had set up in Hong Kong, and enquired about the direct and indirect benefits of the proposed re-domiciliation mechanisms to Hong Kong, including the expected number of OFCs and LPFs that would be re-domiciled to Hong Kong. He also enquired about the assessment criteria SFC would adopt in considering a re-domiciliation application from a non-Hong Kong corporate fund.

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73. Mr CHAN Kin-por and Ir Dr LO Wai-kwok expressed support for the legislative proposals as they would bring more jobs and business opportunities to the local fund and professional services industries. Mr CHAN suggested that the Administration should continue to develop measures to attract multinationals to set up and grow their businesses in Hong Kong. Ir Dr LO referred to the findings of a survey conducted recently by InvestHK on companies in Hong Kong with their parent companies based in other jurisdictions which had pointed out that Hong Kong's simple tax system and low tax rate as well as its proximity to the Mainland were the top favourable factors for setting up businesses in Hong Kong, whereas the top unfavourable factors included the shortage of residential and business accommodation as well as high rental costs. Moreover, the survey also revealed that most companies would keep their business plans and some companies even planned to expand their businesses in Hong Kong.

74. SFST advised that the industry had been calling for an early introduction of re-domiciliation mechanisms for OFCs and LPFs and some industry players were actively considering the relocation of their funds to Hong Kong. Although that was primarily a commercial decision on which the Government was not in a position to provide an estimation, it was projected by some industry estimates that around 2 500 new jobs could be created each year in the local private equity fund and professional services industries with the provision of a facilitative environment for the private equity sector. He added that the Administration would continue to step up efforts in encouraging fund formation and operation in Hong Kong, including organizing activities such as the webinars conducted by the Financial Services Development Council, with a view to promoting Hong Kong as a premier asset and wealth management centre in the Region. Regarding re-domiciliation application for OFC, Director (Investment Products Division), Securities and Futures Commission said that the applicant should provide the relevant re-domiciliation application information/documents to SFC, including a copy of the certificate of incorporation or registration issued with respect to the fund under the law of the place of incorporation or registration, the constitutive document of the fund, a certificate issued by the fund's directors, etc. Moreover, the applicant needed to satisfy the existing requirements applicable to setting up a new OFC as stipulated in SFO, the Securities and Futures (Open-ended Fund Companies) Rules (Cap. 571AQ) and the Code on OFCs, including the eligibility requirements relating to the directors, investment manager and custodian of an OFC.

Conclusion

75. The Chairman concluded that Panel members generally supported the legislative proposals to allow foreign investment funds to re-domicile to Hong Kong as OFCs or LPFs.

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(At 12:53 pm, the Chairman ordered that the meeting be further extended for 10 minutes to 1:10 pm. Members agreed.)

VI Any other business

76. There being no other business, the meeting ended at 1:00 pm.

Council Business Division 1
Legislative Council Secretariat
23 April 2021