

**Information Note for
LegCo Panel on Financial Affairs**

**Policy Initiatives of
the Financial Services and the Treasury Bureau**

Introduction

The 2005 Policy Agenda of the Government of the Hong Kong Special Administrative Region (“the Government”) has been issued on 12 January. This information note elaborates on the new and on-going policy initiatives that relate to the Financial Services and the Treasury Bureau. It also informs Members of the progress regarding our initiatives in the 2004 Policy Agenda.

Financial Services

2005 Policy Agenda

2. The financial services sector plays a key role in Hong Kong’s roadmap towards a more vibrant and competitive economy. The Government will continue to build on our strengths as an international financial centre (“IFC”) and the premier capital formation centre for the Mainland. We will also further promote Hong Kong’s continued development as an international asset management centre. To this end, we will continue our efforts in ensuring a fair, efficient and transparent regulatory regime which is on a par with international standards. Our specific policy initiatives are as follows.

Enhancing Regulatory Framework

3. We attach great importance to maintaining market quality in Hong Kong and are always mindful of the need to ensure our regulatory systems are in line with the prevailing international standards.

4. On the banking regulatory framework, Hong Kong is one of the first group of economies working on the implementation of the new capital adequacy standards for banks issued by the Basel Committee on Banking Supervision (commonly known as “Basel II”). The new standards will further enhance the risk management capability and stability of our banking sector. One of our new policy initiatives this year is to prepare for the implementation of Basel II in Hong Kong by introducing the Banking (Amendment) Bill 2005 into the Legislative Council (“LegCo”).

5. On the securities regulatory front, we have announced in March 2004 measures to improve the regulation of listing and recommended giving statutory backing to important listing requirements. This will be achieved by making statutory listing rules by the Securities and Futures Commission (“SFC”) under the Securities and Futures Ordinance. In parallel, we also aim to introduce within the current legislative year the relevant Securities and Futures (Amendment) Bill into LegCo to include breaches of statutory listing requirements in the market misconduct regime. Public consultation on the proposed legislative amendments commenced on 7 January 2005.

6. On the insurance regulatory framework, in the light of international regulatory trends and developments of the insurance industry, we have been reviewing the institutional set-up of the Insurance Authority and consulted Members and the industry in November 2003 on a proposal to establish an insurance regulatory authority independent of the Government.

We aim to develop a detailed proposal for further consultation within this year.

Upgrading Corporate Governance (“CG”)

7. To ensure market quality, we will continue to work together with other relevant parties in fostering good corporate governance. In this regard, our roadmap can be summarised under three “Cs”, namely *Compliance*, *Culture* and *Collaboration*. Specific initiatives include the implementation of a comprehensive new Code on CG Practices by the Hong Kong Exchanges and Clearing Limited (“HKEx”); provision of CG guidelines or professional development programmes by the relevant professional bodies for their members; facilitation of compliance with the new CG requirements and so on.

8. On the legislative front, we will spearhead two important exercises, including the introduction of the Securities and Futures (Amendment) Bill 2005 as mentioned in paragraph 5 above and a bill to establish an Independent Investigation Board (IIB) and a Financial Reporting Review Panel (FRRP) to LegCo in the current legislative year. The IIB will enhance the oversight of auditors of listed corporations and the FRRP will enquire into the compliance of listed corporations’ financial statements with the relevant accounting standards. The proposal, when implemented, will further ensure an effective regulatory regime for the auditing profession and further enhance the quality of financial reporting of the listed corporations.

Facilitating Market Development

9. The remarkable economic growth in the Mainland provides great opportunities for the further development of Hong Kong’s financial market.

One of the major new policy initiatives this year is to further promote Hong Kong's asset management industry by capitalising on the growing opportunities in the Mainland. We will continue with our efforts in providing a conducive environment for development in this area, including completing as soon as possible the legislative work for giving effect to the exemption of offshore funds from profits tax and the review on estate duty.

10. In addition, we will continue to adopt a multi-pronged approach to facilitate the development of the bond market. We will continue to step up engagement with the industry bodies and market players, encourage public corporations to issue bonds and ensure a conducive environment for bond market development.

11. On the securities side, the prospectus-related provisions in the Companies (Amendment) Ordinance 2004 has come into effect in December 2004. In preparation for the exercise to modernise the existing regulatory regime to accommodate new offering structure, the SFC has conducted research on the legal and regulatory regimes governing public offerings of securities in various common law jurisdictions. It aims to put forward proposals for public consultation in early 2005.

12. On the banking side, we are committed to ensuring the smooth operation of personal renminbi business in Hong Kong, and to exploring how the business scope can be expanded with due regard to the pace of financial reform and liberalisation in the Mainland.

Protection of Investors/Depositors

13. Of no lesser importance is the provision of an appropriate and adequate framework for the protection of investors, especially the smaller

ones. To this end, we will continue our work to implement the Deposit Protection Scheme. The Hong Kong Deposit Protection Board was formed in July 2004 to oversee the establishment of the Scheme. It is expected that the Scheme would be ready for providing deposit protection towards the second half of 2006.

14. On the Mandatory Provident Fund (“MPF”) front, we together with the Mandatory Provident Fund Schemes Authority (“MPFA”) will continue our work on the implementation of the Code on Disclosure for MPF Investment Funds (“MPF Disclosure Code”), which sets out general principles of disclosure and standards regarding disclosure of fees, charges and performance of MPF funds. The MPFA will also move on to the next phase of the MPF Disclosure Project to review and develop proposals for improving scheme member benefit statements required to be provided by MPF trustees to scheme members.

15. On the insurance front, the Insurance Authority will continue to explore whether a scheme for enhancing protection for policyholders against insolvency of insurance companies should be introduced in Hong Kong. We are awaiting the submission of the final report for stage 1 of the study by the consultant. We will consider the way forward upon receiving the consultant’s report.

2004 Policy Agenda

16. This information note also aims to inform Members of Hong Kong’s present position as a major IFC and the progress made in respect of our policy initiatives set out in the 2004 Policy Agenda.

17. In short, Hong Kong has further consolidated its position as a

major IFC. As at the end of 2004, our stock market ranked 9th in the world and 2nd in Asia. Hong Kong has become the world's third largest capital raising market. We are also the world's 12th and Asia's 3rd largest international banking centre. On fund management, a recent survey conducted by the Securities and Futures Commission shows that the total assets in fund management business in Hong Kong in 2003 amounted to HK\$2,947 billion. As for insurance, with 180 insurance companies from over 22 different countries, we have the highest concentration of insurers in Asia.

18. The progress of our initiatives in the 2004 Policy Agenda is as follows -

(a) **work on enhancing regulatory framework**

- ◆ On the regulatory framework for the accounting profession, the Professional Accountants (Amendment) Ordinance was enacted in July 2004 to, among other things, provide for lay members to be appointed to the governing Council and to the Investigation and Disciplinary Panels of the Hong Kong Institute of Certified Public Accountants. The reform has enhanced the independence and transparency of these bodies.

(b) **work on upgrading corporate governance**

- ◆ Over the last year, we have witnessed concrete progress in the implementation of the various CG initiatives. For instance, all the initiatives set out in the CG Action Plan¹

¹ The CG Action Plan was drawn up by the Government, the SFC and the HKEx in 2003.

have now been completed or made considerable progress.

These initiatives include –

- (i) upgrading the Listing Rules and Listing Functions;
- (ii) tightening the regulation of Initial Public Offering intermediaries;
- (iii) effective roll out of the Securities and Futures Ordinance;
- (iv) successful completion of the Standing Committee on Company Law Reform's ("SCCLR") Phase II Corporate Governance Review; and
- (v) early implementation of the SCCLR's Recommendations from its Phase I Corporate Governance Review.

Moreover, the Companies (Amendment) Ordinance 2004 was enacted in July 2004 to, among other things, enhance the protection of shareholders. Salient amendments include the provision of statutory derivative action that may be taken on behalf of a company by a member of the company and the power for the court to award damages to members of a company whose interests have been unfairly prejudiced.

(c) **work on facilitating market development**

(i) Personal renminbi business

Personal renminbi deposit-taking, currency exchange, remittance and renminbi card businesses were successfully launched by banks in Hong Kong in early 2004.

(ii) Promoting the Development of the Bond Market

There has been encouraging progress in the development of our bond market over the past year, with the policy support of the Hong Kong SAR Government and the concerted efforts of the industry. To promote the market development, we have implemented a series of measures, including tax incentives and streamlining of procedures. Besides, the Hong Kong SAR Government has also set a good example by issuing the \$6 billion securitization bonds and the \$20 billion global bond offering earlier this year. The latter one was the largest dual currency and multi-tranche offering from the region, available to both retail and institutional investors at the time. This success demonstrates that Hong Kong possesses the necessary expertise and infrastructure for launching sizable bond programmes.

(iii) Mainland and Hong Kong Closer Economic Partnership Arrangement (“CEPA”)

On the securities side, the commitment under CEPA I simplifies the relevant procedures for Hong Kong professionals applying for securities and futures industry qualifications in the Mainland, and allows them to become first movers to enter the Mainland market.

On the banking side, a number of banks have established or applied for establishing branches in the Mainland since the signing of CEPA I. With the signing of CEPA II in 2004, Mainland branches of Hong Kong banks can conduct

insurance agents' business after obtaining approval.

On the accounting side, the Agreement on the Mutual Examination Paper Exemptions for Mainland and Hong Kong Accountants was signed on 27 August 2004. The mutual exemption of equivalent examination papers will facilitate accountants in the Mainland and Hong Kong to acquire the professional qualifications in both places as soon as possible, with a view to enhancing the cooperation of the accounting sectors in the Mainland and Hong Kong.

On the insurance side, cooperation agreement under CEPA has been signed between the Insurance Authority ("IA") and the China Insurance Regulatory Commission ("CIRC") in February 2004 whereby both parties agreed in principle to establish an examination centre in Hong Kong to facilitate Hong Kong residents to sit for Mainland insurance intermediaries qualifying examinations, whilst arrangements have also been made for Hong Kong residents to take the examinations in Shenzhen. In November 2004, IA has also signed a Co-operative Agreement on Insurance Supervision with the CIRC to facilitate the mutual co-operation, understanding and exchange of information between the two regulators.

(iv) Furthering Hong Kong's development as an international asset management centre

We are working on the drafting of and consultation on the legislative amendments for exempting offshore funds from profits tax. We have also completed public consultation on the review of estate duty.

We have organised a Forum on Management of Insurance Funds in Beijing in November 2004. Some 270 participants from the concerned industries and sectors in the Mainland and Hong Kong have participated in the forum. The forum has successfully fostered experience sharing on management of insurance funds between the Mainland and Hong Kong participants. It has also helped to improve the Mainland insurance sector's understanding of Hong Kong's strengths as the platform for global investment for the Mainland.

We have organised a Forum on Hong Kong as an International Asset Management: Challenges and Opportunities, in conjunction with the Advisory Committee on the Human Resources Development in the Financial Services Sector. The Forum aimed at exploring ways to further enhance our financial services human resources to support Hong Kong's continued development as an international asset management centre. It was well attended by over 300 participants, including market practitioners from all fields in the financial services sector, market analysts, and academics.

(v) On top of the above, the Secretary for Financial Services and the Treasury has also attended and delivered speeches at a large number of forums, seminars and conferences relating to financial services in Hong Kong and overseas to promote Hong Kong's position as an international financial centre and to publicize the excellent investment opportunities and sophisticated services provided by our financial market. He also took those opportunities to explain the policy initiatives and measures undertaken by the Government and regulatory bodies to enhance our regulatory regime, financial infrastructure and corporate governance.

(d) work on upgrading market infrastructure

- ◆ The Clearing and Settlement Systems Ordinance was passed by the Legislative Council in July 2004 and came into operation in November the same year.
- ◆ The Hong Kong dollar was admitted in December 2004 into the Continuous Linked Settlement System, a global clearing and settlement system for cross-border foreign exchange transactions.

(e) work on protection of investors/depositors

- ◆ The Deposit Protection Scheme Ordinance was enacted in May 2004. We are continuing to work on the implementation of the Deposit Protection Scheme.
- ◆ The MPF Disclosure Code was published in June 2004 to set

out general principles of disclosure and standards regarding disclosure of fees, charges and performance of MPF funds.

FISCAL POLICY

Fiscal Targets

19. In the 2005 Policy Agenda, we pledge to achieve the fiscal objectives set out in the 2004 Policy Agenda. The objectives include continuing our efforts to restore fiscal balance, bring public expenditure down to 20% of GDP or below, and reduce Government's operating expenditure to \$200 billion by 2008-09, reviewing our tax base and continuing to implement the asset sale and securitization programme.

20. The Government has to draw on fiscal reserves to cover deficit over the past few years when expenditure exceeded revenue. Whilst we are cautiously optimistic about the economic outlook and the fiscal position for 2004-05 has improved, we still need to address the problem of the fiscal deficit. We are determined to achieve the target of restoring fiscal balance in the Operating and Consolidated Accounts by 2008-09. In this connection, the Financial Secretary has laid down guidelines in the 2004 Budget to gradually reduce government operating expenditure to \$200 billion by 2008-09. Moreover, in line with the principle of "big market, small government", we will bring public expenditure down to 20 per cent of GDP or below.

21. The tax base of Hong Kong is very narrow. When compared with overseas developed economies, we are heavily reliant upon a limited range of taxes to generate the bulk of our tax revenue. The narrowness of our tax base has hampered our ability to manage public finances, particularly in years of economic downturn and adversity.

22. To enhance the healthiness and sustainability of our public finances, there is a need to broaden the tax base. As advised by the Advisory Committee on New Broad-based taxes, which was set up in 2000 to advise on the suitability of new types of broad-based taxes to be introduced in Hong Kong, a Goods and Services Tax (GST) is the most viable option to broaden the tax base. Recently, the Government's internal Study Committee on GST has completed its study and submitted a report to the Financial Secretary with recommendations on how a GST may be introduced in Hong Kong. The Financial Secretary is now considering the recommendations carefully and will announce his plan on how the GST issue will be taken forward in the coming Budget Speech.

23. As part of the asset sale and securitization programme, we have completed the securitisation of the government tolled tunnels and bridges, the restructuring of the capital of the Airport Authority, and further sale of the accumulated stock of civil servant housing loans to the Hong Kong Mortgage Corporation raising a total sum of about \$12 billion in 2004-05. We are also examining the feasibility of selling part of the loans made to students.

24. In addition, some \$20 billion have been raised from the successful issuance of government bonds in July 2004 to fund infrastructural projects which will be beneficial to Hong Kong's long term economic development. The exercise also helped to promote the development of our bond market.

13 January 2005

Financial Services and the Treasury Bureau