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LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS

Information Note on Policy Initiatives of the Financial Services and the Treasury Bureau

INTRODUCTION

This information note outlines the key new and ongoing policy initiatives relating to the Financial Services and the Treasury Bureau ("FSTB") under the 2011-12 Policy Agenda issued on 12 October 2011.

FINANCIAL SERVICES

Overview

2. The financial markets remained turbulent in the past year. In early 2011, investor sentiment was hit by the political instability in the Middle East and North Africa region and the Japan earthquake and nuclear crisis. Ensuing concern over the fiscal crisis in European economies and the downgrade of US sovereign credit rating have further heightened the risk aversion among market participants.

3. Sweeping financial reforms implemented by advanced economies in response to the institutional failures exposed by the financial crisis in 2008 have brought about far-reaching implications to the financial services sector globally.

4. The financial services sector in Hong Kong has demonstrated a high degree of resilience throughout the past few years. Financial institutions remained generally stable, with no firms requiring public bailout. The regulatory framework has proven to be robust and sound in guarding against systemic failures. Yet there is no room for complacency, especially in the light of recent re-emergence of market turbulence in the global financial markets. Given our high degree of interconnectedness to overseas financial centres, the Government and regulators are monitoring the situation closely. We will stay vigilant to the latest development in the

international financial environment and act swiftly as and when necessary to ensure the proper functioning of our financial markets.

5. In parallel, we have been striving to strengthen the competitiveness of our financial system and proactively seizing new business opportunities arising from the shift of economic gravity from the West to the East. As set out in the National 12th Five-Year Plan published in March 2011, the Central People's Government has been supporting Hong Kong in consolidating and enhancing our position as an international financial centre, developing into an offshore renminbi ("RMB") business centre and an international asset management centre, and consolidating and enhancing our global influence in the financial sector. The package of measures related to financial development as announced by Vice-Premier Li Keqiang in August 2011 will further expedite the growth of local financial markets and institutions, particularly regarding RMB business.

6. Our solid position as China's Global Financial Centre has been duly reflected in the burgeoning businesses. Hong Kong was the world's top centre for initial public offerings in both 2009 and 2010, with an increasingly broadened source of companies listed on our stock exchange. Hong Kong has also become the premier centre for offshore RMB business, being the first offshore RMB bond market and the leading centre for RMB trade settlement since 2007 and 2009 respectively. Hong Kong is a major asset management hub in Asia as well, with more than 60% of fund management business sourced from overseas. Moreover, we secured additional market access rights for our financial services and products in the Mainland, including cross-location sub-branches for banks.

2011-12 Policy Agenda

7. Hong Kong will continue to build a robust financial system that is in line with international best practice and provide a level playing field for market participants. Relevant authorities will work relentlessly to improve our market quality, promote investor protection and facilitate market development. The ensuing paragraphs seek to highlight the key initiatives in these areas.

I. Improving Market Quality and Investor Protection

Enhancing disclosure and financial infrastructure

(a) Statutory codification of requirements to disclose price sensitive information ("PSI") by listed corporations

8. A statutory regime to oblige listed corporations to disclose PSI is necessary to enhance market transparency and quality, bring our regulatory regime for listed corporations more in line with those of overseas jurisdictions, and sustain Hong Kong's position as a premier capital formation centre. After public consultation in 2010, we introduced the Securities and Futures (Amendment) Bill 2011 into the Legislative Council ("LegCo") in June 2011 to, among other things, establish a statutory PSI disclosure regime. In devising the statutory regime, we seek to promote effective compliance with, and allow effective enforcement of, the disclosure obligations. We will work with the Bills Committee with a view to enacting the statutory requirements in this legislative session.

(b) Developing a scripless securities market

9. The Working Group on Scripless Securities Market[1] published in 2010 the consultation conclusions on the proposed operational model for a scripless securities market. The Government will continue to support this important initiative to enhance the overall efficiency and competitiveness in the securities market, and to secure an appropriate and improved level of investor choice and protection. We are now working closely with the Securities and Futures Commission ("SFC") on further legislative amendments to facilitate the implementation of a scripless regime in Hong Kong. The SFC plans to launch a consultation on the relevant subsidiary legislation in early 2012.

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[1] The Working Group is a tripartite forum, led by the Securities and Futures Commission and drawing members from the Hong Kong Exchanges and Clearing Limited and the Federation of Share Registrars.

Meeting international financial requirements

(c) *Enhancing the anti-money laundering regulatory regime for the financial sectors*

10. Following the enactment of the Anti-Money Laundering and Counter Terrorist Financing (Financial Institutions) Ordinance, Cap. 615 ("AMLO") in June 2011, the regulatory authorities have drawn up the relevant guideline to facilitate compliance with the statutory requirements by the relevant financial sectors and issued the draft guidelines for consultation with interested parties in September 2011. Taking into account the views and comments received, the regulatory authorities aim to finalise the guideline for promulgation by end January 2012 to allow reasonable time for the financial sectors to make preparation for the commencement of the AMLO on 1 April 2012. Implementation of the new legislation will enhance the anti-money laundering regulatory regime for the financial sectors in Hong Kong.

(d) *International financial reforms*

11. Hong Kong has continued to participate constructively in the relevant international financial fora, including the Financial Stability Board, in their deliberations on financial reforms. Hong Kong has also joined the Group of Twenty ("G20") Summits as part of China's delegation. We will continue with our active participation in these international fora and consider how best to refine our regulatory regime in the light of developments in other international financial centres. Latest efforts include the development of a regulatory regime for over-the-counter ("OTC") derivatives and implementation of new Basel requirements for banks.

12. OTC derivatives. We are working together with the SFC and the Hong Kong Monetary Authority ("HKMA") to establish a regulatory regime for OTC derivatives to implement the relevant G20's recommendation. The proposed regime will require certain classes of OTC transactions to be reported to the trade repository operated by the HKMA and mandate certain classes of OTC transactions to be cleared with central counterparties to be designated by the SFC.

13. New Basel requirements for authorised institutions. We will implement in Hong Kong the enhancements to the Basel II framework announced by the Basel Committee on Banking Supervision ("BCBS") in July 2009. To this end, the HKMA has consulted the local banking industry on the draft legislative amendments to the Banking (Capital) Rules and Banking (Disclosure) Rules under the Banking Ordinance ("BO") for effecting the enhancements. We are finalising the amendment rules with a view to tabling them for negative vetting by LegCo in October 2011. Subject to LegCo's consideration, our plan is to bring the amendment rules into operation starting January 2012, in line with the BCBS' timetable.

14. The BCBS has also put forward a set of enhanced capital requirements and global liquidity standards (collectively known as "Basel III"), which will be phased in between 1 January 2013 and 1 January 2019, so as to enhance the resilience of the global banking system. We intend to implement Basel III in Hong Kong in accordance with the BCBS' timetable, including the transitional arrangements. In this connection, we are preparing the legislative amendments to the BO with a view to introducing the amendment bill into LegCo as soon as possible in the current legislative session. In parallel, the HKMA will formulate other necessary rules under the BO and supervisory guidance for the implementation of Basel III.

Strengthening regulatory regime and investor protection

(e) Preparing key legislative provisions for the establishment of an independent Insurance Authority ("IIA")

15. We propose to establish an IIA for better protection of insurance policyholders, greater nimbleness in responding to regulatory challenges and more effective implementation of international standards. Having completed a public consultation exercise on the proposed regulatory framework in 2010, we noted that there was general public support for the establishment of an IIA. Having released the detailed proposals in June 2011, we are engaging the industry and relevant stakeholders with a view to making available draft key legislative provisions for further public engagement in the first half of 2012.

(f) *Preparing for establishment of a Policyholders' Protection Fund ("PPF")*

16. To better protect insurance policyholders' interest and maintain market stability in the event of insurer insolvency, we propose to establish a PPF as a safety net for policyholders. We have completed a public consultation exercise in June 2011. We aim to announce the consultation conclusions and finalised proposals in early 2012.

(g) *Establishment of an investor education council and a financial dispute resolution scheme*

17. We are preparing for the establishment of a cross-sectoral Investor Education Council ("IEC") to enhance the financial literacy of our investing public in Hong Kong. We introduced into LegCo in June 2011 the Securities and Futures (Amendment) Bill 2011 which would, among other things, enable the IEC to be established under the SFC.

18. In addition, we have obtained funding approval from LegCo for the establishment of a Financial Dispute Resolution Centre ("FDRC") to provide an independent and affordable avenue for resolving monetary disputes between individual consumers and financial institutions. We aim at establishing the FDRC by mid-2012.

(h) *Improvement of the Mandatory Provident Fund ("MPF") system*

19. The Government and the Mandatory Provident Fund Schemes Authority ("MPFA") are pressing ahead with the implementation of the Employee Choice Arrangement ("ECA") to increase market competition, which is expected to help bring down fees and charges. We briefed the LegCo Panel on Financial Affairs ("FA Panel") in April 2011 on the legislative proposals for the regulation of MPF intermediaries, and published the consultation conclusions and detailed legislative proposals in July 2011. We plan to introduce the relevant bill into LegCo in Q4 2011. Subject to enactment of the bill within the current LegCo term, the MPFA aims to commence the ECA in the second half of 2012.

20. Since the inception of the MPF system, trustees have been making contributions to the Mandatory Provident Fund Schemes Compensation Fund at an annual levy rate of 0.03% of the net asset value of MPF scheme assets. The MPFA has conducted a review taking into account the risk level, as well as local and overseas experiences, and proposed to introduce an automatic adjustment mechanism which will result in suspending the levy. We expect that the saving will be passed onto scheme members in the form of reduced MPF fees and charges. We will consult the FA Panel in Q4 2011, and subject to its view, introduce amendments to relevant subsidiary legislation in Q2 2012.

21. As part of the ongoing review of the MPF system, the MPFA will consult the public shortly on its proposals regarding withdrawal of MPF benefits before drawing up recommendations to the Government. The MPFA is also proceeding with a feasibility study on the establishment of a central database of all contributions by employers and employees as well as other relevant information, as part of its study on full portability. In parallel, the MPFA will commission a study on the cost structure of trustees, with a view to identifying ways to further reducing MPF fees and charges.

II. Facilitating Market Development

Advancing financial cooperation with the Mainland

22. In the coming year, we will continue to strengthen financial cooperation with the Mainland through various platforms, including in particular the Closer Economic Partnership Arrangement ("CEPA") and the financial cooperation with Guangdong (see paragraph 24 below). Supplement VIII to CEPA is expected to be signed within this year and efforts are being made for further liberalisation measures in the financial services sectors.

Developing offshore RMB business in Hong Kong

23. There has been significant progress in the development of offshore RMB business in Hong Kong in 2011. The National 12th Five-year Plan pledges the Central Government's support for Hong Kong's development as an offshore RMB business centre. The package of

measures announced by Vice-Premier Li Keqiang in August 2011 further reinforced the Central Government's support in strengthening Hong Kong's position as an offshore RMB business centre. We are working closely with the relevant Mainland authorities, our financial regulators and the market for early implementation of these measures.

Strengthening Hong Kong-Guangdong cooperation on financial services

24. Over the past year, financial services involving Hong Kong and Guangdong have recorded healthy growth. For example, as at end September 2011, four banks with Hong Kong capital had set up a total of 14 sub-branches in Guangdong. As at July 2011, 125 Guangdong enterprises had been listed in Hong Kong; the Hong Kong subsidiaries of six securities companies, four fund management companies and three futures companies from Guangdong had obtained licences to carry on regulated activities in Hong Kong. The governments and financial regulators of both sides will, under the "early and pilot implementation" policy, continue to strengthen Hong Kong-Guangdong cooperation on financial services, and take forward specific initiatives through different platforms, including the Hong Kong/Guangdong Cooperation Joint Conference.

Broadening the source of listed companies

25. The Listing Committee of the Stock Exchange of Hong Kong ("SEHK") has been expanding the list of approved jurisdictions of incorporation for overseas companies seeking a listing on the SEHK. As at end August 2011, 22 jurisdictions had been accepted, including a number of European and emerging economies (such as France, Germany, Italy, Luxembourg and Brazil). In the past year, we had the first Brazilian company, the first Swiss company and the first Kazakhstani company listed in Hong Kong. There were also companies from Italy, Japan and the USA listed on the SEHK in the past year. We will continue to engage SEHK and SFC with a view to attracting secondary listings by overseas companies.

Promoting asset management business

26. Hong Kong has developed itself into a premier asset management hub in Asia and our fund management businesses have been taken to new heights in recent years. As at end 2010, the combined fund management business of Hong Kong reached a record high of $10,091 billion, representing a year-on-year increase of 18.6%. 66% of the funds managed in Hong Kong were sourced from non-Hong Kong investors, showing that Hong Kong is a preferred location for overseas fund managers to conduct asset management business. Moreover, the National 12th Five-year Plan affirmed the Central Government’s support for Hong Kong to develop as an international asset management centre.

27. We will continue to adopt a multi-pronged approach to attracting and anchoring international liquidity, products and talents to Hong Kong. Latest efforts include establishing a network of comprehensive agreements for the avoidance of double taxation with major trading and investment partners; stepping up overseas promotion, in order to enhance the competitiveness of Hong Kong’s asset management industry; and updating our legislation to facilitate market development, like modernising the trustee law and refining the tax laws for Islamic bonds.

28. <u>Trustee law</u>. We are preparing legislation to update the Trustee Ordinance and the Perpetuities and Accumulations Ordinance with a view to strengthening the competitiveness of our trust services industry and attracting more high net worth individuals to create and administer trusts based on Hong Kong laws. This will contribute to building Hong Kong into a major asset management centre. We are finalising the draft bill for consultation in the first half of 2012.

29. <u>Islamic bonds</u>. We will also continue to develop an Islamic finance platform to diversify our asset management industry. To this end, we will continue to enhance our market infrastructure, encourage product development, foster collaboration with other Islamic finance centres, promote education among market participants and investors, and raise the profile of Hong Kong as an Islamic finance platform. We are amending the Inland Revenue Ordinance and Stamp Duty Ordinance with a view to leveling the playing field for common types of Islamic bonds (i.e. sukuk)

vis-à-vis their conventional counterparts as far as tax liabilities are concerned. We will continue to engage major market players in the Islamic finance industry to ensure that the legislative proposals (including those concerning the features of sukuk transactions and tax treatment) could cater for the evolving nature of sukuk transactions and better meet the latest market needs.

Developing the local bond market

30. We will continue with our efforts to promote the further development of the local bond market, including ongoing implementation of the Government Bond Programme. In this connection, we will continue to engage major market players with a view to better meeting the evolving market needs.

Modernising legislative frameworks

(a) Modernising the insolvency provisions and introducing a new corporate rescue procedure

31. We propose to modernise the insolvency provisions under the Companies Ordinance ("CO"), with a view to facilitating more efficient administration of the winding-up of companies and enhancing protection of creditors, having regard to international experience and practices. We are also studying how best to take forward the proposal to introduce a new corporate rescue procedure, which aims at providing companies in financial trouble with an opportunity to turn around. We plan to consult the FA Panel later this year on the proposed scope of this exercise.

(b) Rewriting the CO

32. We introduced the Companies Bill into LegCo in January 2011 with a view to enhancing corporate governance, ensuring better regulation, facilitating business and modernising our company law. The Bill is being scrutinised by a Bills Committee. With support from Members, we hope to secure enactment of the Bill by July 2012. We shall then proceed to make subsidiary legislation in the 2012-13 legislative session. Upon its commencement tentatively scheduled in 2014, the Companies Bill will help

strengthen Hong Kong's status as an international business and financial centre.

THE TREASURY

33. We will continue to strive to expand Hong Kong's network of comprehensive agreements for the avoidance of double taxation ("CDTA") so as to further improve the business environment and facilitate flows of trade, investment and talent between Hong Kong and the rest of the world, thereby enhancing the position of Hong Kong as an international financial and business centre. We will in due course keep the FA Panel informed of the progress of our CDTA negotiations and the latest international trend on exchange of tax information.

Financial Services and the Treasury Bureau
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