立法會
Legislative Council

LC Paper No. CB(1)930/12-13
(These minutes have been seen by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of meeting
held on Monday, 4 February 2013 at 9:00 am
in Conference Room 1 of the Legislative Council Complex

Members present :

Hon Starry LEE Wai-king, JP (Chairman)
Hon CHAN Kin-por, BBS, JP (Deputy Chairman)
Hon Albert HO Chun-yan
Hon James TO Kun-sun
Hon Abraham SHEK Lai-him, SBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon WONG Ting-kwong, SBS, JP
Hon Ronny TONG Ka-wah, SC
Hon Mrs Regina IP LAU Suk-yee, GBS, JP
Hon James TIEN Pei-chun, GBS, JP
Hon NG Leung-sing, SBS, JP
Hon Kenneth LEUNG
Hon Dennis KWOK
Hon Christopher CHEUNG Wah-fung, JP
Hon SIN Chung-kai, SBS, JP

Members attending :

Dr Hon KWOK Ka-ki
Dr Hon CHIANG Lai-wan, JP

Member absent :

Hon CHAN Kam-lam, SBS, JP

Public officers attending	**:**	Agenda Item IV Mr Norman CHAN, GBS, JP Chief Executive Hong Kong Monetary Authority Mr Peter PANG, JP Deputy Chief Executive (Development) Hong Kong Monetary Authority Mr Eddie YUE, JP Deputy Chief Executive (Monetary) Hong Kong Monetary Authority Mr Arthur YUEN, JP Deputy Chief Executive (Banking) Hong Kong Monetary Authority Agenda Item V Ms Julia LEUNG, SBS, JP Under Secretary for Financial Services and the Treasury Agenda Item VI Ms Elizabeth TSE, JP Permanent Secretary for Financial Services and the Treasury (Treasury) Ms Mable CHAN, JP Deputy Secretary for Financial Services and the Treasury (Treasury) 2 Ms Shirley KWAN Principal Assistant Secretary for Financial Services and the Treasury (Treasury) (Revenue) Mr CHIU Kwok-kit, JP Deputy Commissioner of Inland Revenue (Technical)

Ms Agnes CHEUNG
Senior Government Counsel (Treaties & Law)
Department of Justice

Agenda Item VII

Miss Salina YAN, JP
Deputy Secretary for Financial Services and the Treasury (Financial Services) 1

Attendance by invitation :

Agenda item V

Mrs Laura CHA, GBS, JP
Chairman
Financial Services Development Council

Mr Kent YAU
Head/Secretariat
Financial Services Development Council

Agenda item VII

Mr Carlson TONG, JP
Chairman
Securities and Futures Commission

Mr Ashley ALDER
Chief Executive Officer
Securities and Futures Commission

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

Mr Paul YEUNG
Commission Secretary
Securities and Futures Commission

Clerk in attendance :

Ms Connie SZETO
Chief Council Secretary (1)4

Staff in attendance :	Miss Winnie LO (Item VI only) Assistant Legal Adviser 7
	Ms Angel SHEK Senior Council Secretary (1)4
	Ms Sharon CHAN Legislative Assistant (1)4

Action

I Confirmation of minutes of meetings and matters arising

(LC Paper No. CB(1)485/12-13	—	Minutes of the joint meeting on 2 November 2012
LC Paper No. CB(1)486/12-13	—	Minutes of the special meeting on 19 November 2012)

The minutes of the joint meeting held on 2 November 2012 and the special meeting on 19 November 2012 were confirmed.

II Information papers issued since the last meeting

(LC Paper No. CB(1) 449/12-13(01)	—	Letter from Hong Kong Journalists Association on matters relating to Companies (Residential Addresses and Identification Numbers) Regulation to be made under the new Companies Ordinance dated 10 January 2013 (Chinese version only))

2. Members noted the information paper issued since the last regular meeting held on 7 January 2013.

III Date of next meeting and items for discussion

(LC Paper No. CB(1)484/12-13(01) — List of outstanding items for discussion

LC Paper No. CB(1)484/12-13(02) — List of follow-up actions)

3. Members agreed to discuss the following items proposed by the Administration at the next regular meeting scheduled for 4 March 2013:

(a) Proposed legislation on the regulation of over-the-counter derivatives market; and

(b) Relevant income level for the purpose of mandatory contribution under the Mandatory Provident Fund Schemes Ordinance.

IV Briefing on the work of the Hong Kong Monetary Authority

(LC Paper No. CB(1)484/12-13(03) — Paper provided by the Hong Kong Monetary Authority)

Presentation

4. At the invitation of the Chairman, the Chief Executive, Hong Kong Monetary Authority ("CE/HKMA"), the Deputy Chief Executive (Development)/HKMA ("DCE(D)/HKMA"), the Deputy Chief Executive (Banking)/HKMA ("DCE(B)/HKMA") and the Deputy Chief Executive (Monetary)/HKMA ("DCE(M)/HKMA") gave a powerpoint presentation on the updates on global and Hong Kong financial and economic conditions, banking stability, financial infrastructure, risks assessment of the property and mortgage markets, development of Renminbi ("RMB") business and performance of the Exchange Fund ("EF").

(*Post-meeting note*: The notes of the powerpoint presentation (LC Paper No. CB(1)555/12-13(01)) were issued to members vide Lotus Notes e-mail on 14 February 2013.)

Discussion

Banking supervision

5. Mr Dennis KWOK noted that several overseas regulatory authorities had investigated into the incident of UBS manipulating the interest rates, including the London Interbank Offered Rate ("LIBOR"), and the bank was

fined a huge sum for rigging the LIBOR. Noting that HKMA had also commenced investigation on UBS regarding allegation of similar misconduct in relation to the Hong Kong Interbank Offered Rate ("HIBOR"), Mr KWOK enquired about the progress of the inquiry and enforcement actions of HKMA if the allegation was confirmed.

6. DCE(B)/HKMA said that HKMA had announced in December 2012 that it was investigating into the allegation. As the investigation involved inspection of voluminous internal correspondences among the traders of the bank in order to ascertain whether there had been irregularities and manipulation of the HIBOR, it would take some time to complete the investigation. He said that as the investigation was still in progress, HKMA could not comment on the actions to be taken at this stage. CE/HKMA said that The Hong Kong Association of Banks ("HKAB") had commissioned the Treasury Markets Association to undertake a review of the HIBOR fixing mechanism and governance process with a view to enhancing transparency and effectiveness of the regime. The HKAB had also conducted a consultation with 77the industry on related issues and had provided HKMA with a consultation report. HKMA was considering the consultation report and would respond to HKAB in due course.

7. Mr Dennis KWOK expressed concern about whether HKMA would have sufficient power under the Banking Ordinance (Cap.155) ("BO") and manpower resources to undertake investigation on UBS. CE/HKMA and DCE(B)/HKMA said that there were powers under BO for HKMA to conduct investigation and take disciplinary actions against authorized institutions, such as revocation of their licence or registration. DCE(B)/HKMA advised that the Enforcement Department of HKMA was responsible for undertaking the investigation. HKMA had strengthened the manpower in the Enforcement Department in recent years having regard to the increasing caseload. HKMA would keep in view its manpower resources and seek to increase manpower where required to ensure its investigation work would be conducted in a professional and effective manner.

Exchange Fund

8. Mr Kenneth LEUNG noted that a substantial part of the EF was invested in private equity ($47.1 billion) and real estate ($13.5 billion) as at end 2012. In view of the relatively low liquidity of assets held under these classes, he enquired if HKMA had set any limit on investment under these classes, and details of the investment return and risk management measures. CE/HKMA said that private equity and real estate were among the new asset classes under the Long-Term Growth Portfolio ("LTGP") of EF for medium and long-term investment, which was an arrangement made since 2008 to

diversify EF's investment into more asset classes. The investment of LTGP was capped at a level equivalent to one-third of the Accumulated Surplus of EF. CE/HKMA added that, having regard to the statutory purposes of EF for maintaining the stability and integrity of the monetary and financial systems in Hong Kong, and the relatively low liquidity of private equity and real estate assets, the current ceiling was considered appropriate. As regards the investment return of private equity and real estate, DCE(M)/HKMA said with reference to slide 27 of the powerpoint that the annualized since-inception return of the private equity and real estate investments was 10% . He pointed out that private equity and real estate were longer-term investments and there should not be too much focus on their short-term performance. He said that HKMA had put in place internal guidelines for investment risk management and control.

9. Noting that the five-year average investment return of EF was 1.8% for the period of 2008 to 2012, Mr SIN Chung-kai enquired whether this rate would apply to the return on the fiscal reserves placed with EF for 2012. DCE(M)/HKMA explained that the fees payable for the Fiscal Reserves placed with EF was calculated based on the average annual return over the past six years of the Investment Portfolio of EF, and not EF itself. Information on the investment return for the fiscal reserves placed with EF in 2012 would be incorporated in the 2013-2014 Budget to be announced by the Financial Secretary ("FS"). CE/HKMA supplemented that EF also comprised a Backing Portfolio which mainly held US dollar-denominated assets with high liquidity in order to provide full backing to the Monetary Base. Given the low yield of these quality assets, the Backing Portfolio generated a lower return than the Investment Portfolio. For instance, the return of the Backing Portfolio was 0.4% in 2012 while the Investment Portfolio was able to achieve an 8% return. To even out fluctuation in the fees payable for the Fiscal Reserves placed with EF, a rate being the six-year average of the annual rate of return of EF's Investment Portfolio was thus adopted. In response to the further enquiry of Mr SIN, DCE(M)/HKMA said that, as at end 2012, the total asset size of EF stood at $2,780 billion, with the Backing Portfolio and Investment Portfolio amounted to $1,316 billion and $1,240 billion respectively.

10. Referring to slides 27 and 28 of the powerpoint, Mr James TO asked whether the three asset classes, i.e. emerging market bonds and equities, private equity and real estate, in the LTGP contained any RMB assets. He also sought the reasons for HKMA making the arrangement to transfer the emerging market bonds and equities as well as RMB assets into EF's Investment Portfolio while keeping the private equity and real estate assets in the LTGP, in particular whether the arrangement had anything to do with the internal division of work in HKMA and fees/commissions for external fund managers.

11. CE/HKMA said that private equity and real estate were retained in the LTGP in view of the relatively low liquidity of such assets. The transfer of the emerging market bonds and equities and RMB assets into the Investment Portfolio had taken into account the growth in depth and liquidity of the markets of these two asset classes since inception of the LTGP. The arrangement only entailed a transfer of assets to a different portfolio of EF for investment management and assessment, and did not involve changes in the manpower or internal division of work in HKMA. DCE(M)/HKMA supplemented that most of the bonds held by EF were managed by HKMA in-house staff while equities were managed by external managers. In the investment process, HKMA would determine the asset allocation with regard to the investment benchmark. HKMA considered that placing the emerging market bonds and equities as well as the RMB assets into the Investment Portfolio would be conducive to portfolio diversification. As to whether HKMA would consider increasing the holding of RMB assets in the Investment Portfolio, CE/HKMA said that the market value of RMB assets held by EF was $46.9 billion as at end 2012. In view of the positive outlook on RMB assets for long-term investment, HKMA was interested to increase its asset allocation in RMB assets.

12. Mr Abraham SHEK and the Chairman appreciated that EF had achieved good investment return in 2012. The Chairman said that she supported HKMA's initiative to diversify the investment of the EF. In view of repeated calls from the community and the Legislative Council ("LegCo") for the Government to buy back The Link Real Estate Investment Trust, the Eastern Harbour Crossing and the Western Harbour Crossing, and to increase its share holdings in the MTR Corporation Limited ("MTRCL"), the Chairman enquired if HKMA would consider the overall benefits of Hong Kong and the general public when making investment of EF apart from the potential investment return.

13. CE/HKMA said that the investment strategy of EF was determined having regard to its statutory objectives. Sufficient liquidity would be required for the purposes of maintaining monetary and financial stability of Hong Kong while HKMA strived to achieve an investment return to preserve the long-term purchasing power of EF. Supporting the development of Government-invested or public enterprises was not among the considerations for EF's investment. Apart from Hong Kong equities (including but not limited to shares in Hong Kong Exchanges and Clearing Limited ("HKEx") acquired by the Government), EF was not holding other Hong Kong assets (except the office premises of HKMA). CE/HKMA further explained that the holding of Hong Kong equities in the Investment Portfolio of EF was the result of the Government's market operation in 1998 acquiring a substantial portfolio of

Hong Kong shares. Most of the shares were subsequently disposed of as the Tracker Fund of Hong Kong, while the remaining Hong Kong equities were retained in EF. HKMA engaged the service of external fund managers to manage the Hong Kong equities portfolio held by EF, and HKMA did not participate in the day-to-day management of these assets.

14. Referring to slide 25 of the powerpoint, Mr CHAN Kin-por observed that there was a drop in investment income from bonds on a quarter-to-quarter basis in 2012 (i.e. -$2.9 billion in the first quarter of 2012, $22.7 billion in the second quarter, $10.8 billion in the third quarter and $2.5 billion in the fourth quarter). He expressed concern about the adverse impact on the bond investment if the current trend of low interest rate reversed. CE/HKMA said that the low interest rate environment had made it difficult to yield a high investment return from bonds, and the return of the Backing Portfolio in 2012 was some 0.4%. A rise in the interest rate would lead to a drop in the mark-to-market prices of the bonds. Taking the risk of an interest rate rise into consideration, HKMA had been prudent and careful in making investment with a view to securing a reasonable return for EF.

15. Mr James TO noted that there were similarities in the investment strategies for EF's LTGP and a typical sovereign wealth fund ("SWF"). He enquired whether HKMA would consider using EF as a vehicle to establish a SWF in Hong Kong. CE/HKMA pointed out that the statutory objectives of EF were different from that of SWFs, which usually were set up for maximizing long-term return by investing in low liquidity assets, and were typically created when governments had budgetary surpluses and aimed to build up savings for future generations. While there were similarities in the investment objectives of LTGP under EF and the SWFs, EF, having regard to its statutory functions, was not intended to be a SWF.

Impact of the global financial and economic environment

16. Mr NG Leung-sing noted that the economy of the United States ("US") was predicted to grow by 2% year-on-year in 2013, while the latest forecast of the growth of Hong Kong's economy for the year was adjusted upward from 1.4% to 3.4%. He enquired about the major sectors in Hong Kong which would benefit from the economic growth. CE/HKMA said that as an open economy, Hong Kong was affected by the economic conditions of the US and European markets. The US economy was projected to grow by some 2% in 2013, and the recession in Europe had not worsened for the time being. The market outlook for 2013 appeared to have improved. From a low base in 2012, Hong Kong was able to achieve a greater extent of economic growth, including acceleration in financial intermediation.

17. Mr NG Leung-sing enquired about the impact of Japan's unlimited quantitative easing programme on Hong Kong economy, and the measures to alleviate possible adverse impacts. CE/HKMA said that Japan had been implementing quantitative easing for some time to stimulate economic growth. While the Japanese government had adjusted the target inflation rate from 1% to 2% recently, inflation rate had remained low at -0.2% in 2012 and was estimated to rise slightly to 0.4% in 2013. Although the central bank of Japan forecasted a 2.9% inflation rate for 2014, the figure would be lowered to 0.9% after discounting the impact of an increase in its value added tax from 2013. As such, whether Japan's inflation target of 2% would be achievable had yet to be observed. Nevertheless, fiscal measures implemented by the Japanese government were expected to stimulate its domestic consumption in the near term, although this would be achieved at the expense of pushing up the national debts.

18. Mr Abraham SHEK sought CE/HKMA's views on the movement of the US dollar. Mr CHAN Kin-por expressed concern that the quantitative easing measures undertaken by the major economies (e.g. US, the Euro zone and Japan) to increase money supply and depreciate their currencies would accentuate the assets bubble risk in the property and equity markets.

19. CE/HKMA said that it was difficult to predict with precision the movement of the US dollar since the exchange rate of a currency was affected by various factors, and quantitative easing measures might not necessarily lead to depreciation of a currency. For instance, despite the quantitative easing by the US and Japan, the value of the yen had dropped by some 10% after the general election in December 2012 while the US dollar had appreciated. Similarly, notwithstanding the quantitative easing implemented by the European Central Bank, the Euro had appreciated against the US dollar.

20. Mr Abraham SHEK enquired about the US interest rate trends. He expressed concern about the impact of a possible reversal of the low interest rate on the local property market. CE/HKMA said that the quantitative easing measures implemented by the central banks were aimed at stabilizing or raising asset prices by lowering the short-term market interest rates. As observed, the real estate market in US had improved under its three rounds of quantitative easing. While the US Federal Reserve projected an economic growth in the US of 2.3% to 3% in 2013, the actual outturn would be affected by the ongoing negotiation between the US political parties on issues relating to expenditure cuts and related measures to alleviate the impact on the US economy. The economy of US had slightly contracted in the fourth quarter of 2012 as a result of the cutdown in national defence expenditures. On the other hand, the US and European equity markets performed well recently but whether the positive performance would sustain in the longer term had yet to be observed as the risk of a possible reversal of the low interest rate remained. CE/HKMA further said

that the low interest rate environment had increased the inflow of capital into Hong Kong and fuelled the property boom. While it was difficult to accurately predict the interest rate movement or the circumstances that might trigger a reversal in the rate, it was certain that the current extremely low interest rate environment could not last indefinitely. As such, mortgage borrowers should stay vigilant of the risks.

Property market and mortgage lending

21. Mr Albert HO noted that the credit growth had slowed down substantially from 28.6% in 2010 to 9.6% in 2012 as shown in slide 13 of the powerpoint. He asked if the slow-down was mainly seen in the residential property mortgage lending market. He also enquired whether the latest measures to address the overheated residential property market had served to constrain the demand for mortgage loans. DCE(B)/HKMA said that many Mainland enterprises had raised funds through Hong Kong or borrowed from Hong Kong banks in 2010 and 2011, but the growth in these financing activities had decelerated in 2012. As regards residential property mortgage lending, the total amount of loans had remained stable in the past two to three years. Although new loans were taken, the outstanding loan amount had not changed substantially due to fast repayment of loans in a low interest rate environment. For risk management, HKMA had launched five rounds of countercyclical macroprudential measures in the past few years to enhance resilience of the banking sector against a property market downturn. The measures were effective at large. The loan-to-value ratio of new mortgage loans had lowered to slightly above 50% while the debt servicing ratio was about 36%.

22. Referring to slide 14 of the powerpoint, the Chairman noted HKMA's assessment that the overheated property market remained the biggest threat to Hong Kong's financial stability as property market developments had become disconnected from economic fundamentals and household incomes. She also observed that the household debt burden had reached 58% of the Gross Domestic Product ("GDP") in the third quarter of 2012. The Chairman enquired if HKMA would implement appropriate measures when the household debt burden rose to a warning level. CE/HKMA pointed out that the growth in household debt was not just attributed to residential mortgage but also credit card and other personal loans. Although it was difficult to set a quantifiable level of household debt burden in terms of GDP that would be regarded as highly risky, historical data showed that the current household debt burden level had already hiked near the record high of 60% in 2002. As such, the public should be alert to the associated risks arising from a possible rise in interest rate. He cautioned that, if cyclical economic changes set in, all sectors of the economy, and not just the property market, would be affected.

Offshore Renminbi business

23. Mr NG Leung-sing noted that the circulation of RMB funds between Hong Kong and the Mainland would be enhanced along with the cross-border lending arrangement under the development of Qianhai. He enquired if similar business opportunities in other Mainland cities, such as Nansha and Hengqin, would be explored. CE/HKMA said that the Qianhai co-operation was a pilot project for the granting of cross-border RMB loans. He believed that if the initiatives yielded good results, it would be worthwhile to extend the framework to cover other areas in the Mainland.

V Briefing by the Financial Services Development Council

(LC Paper No. CB(1)484/12-13(04)	—	Paper provided by the Financial Services Development Council
LC Paper No. FS21/12-13	—	Fact sheet on "Financial Services Development Council" prepared by the Legislative Council Secretariat (Chinese version only))

Presentation

24. With the aid of a powerpoint presentation (LC Paper No. CB(1)484/12-13(04)), the Chairman, Financial Services Development Council ("C/FSDC") briefed members on the background for the establishment of FSDC, the report and recommendations of the Preparatory Task Force on the Financial Services Development Council ("PTF"), the role and membership of FSDC, as well as its work plan and resources arrangement. She advised that five committees had been set up under FSDC for undertaking in-depth studies in respect of five areas, namely, financial development research, mainland opportunities, new business, human capital, and market development. C/FSDC emphasized that FSDC would not take on any policy execution, or statutory/regulatory functions. As regards the proposal to set up FSDC as a company limited by guarantee, she explained that this had taken on board PTF's recommendation in the light of overseas and local experiences, with a view to facilitating better governance of and lending greater flexibility to the operation of FSDC as well as projecting a clear image of FSDC. On concern about the transparency of FSDC if it operated as a company limited by

guarantee, C/FSDC said that, if such a company was to be set up, information on the company's directors and office, as well as its directors' report and audit report would be made available for public inspection as required under the Companies Ordinance. FSDC would submit its budget and work plan to the Government for approval and report its work to LegCo. She added that if the company was to be set up, it would be established by the Financial Services and the Treasury Bureau ("FSTB") in accordance with the applicable procedures.

Discussion

Role of FSDC and the proposal to set up FSDC as a company limited by guarantee

25. Mr Abraham SHEK expressed concern about rationale for setting up FSDC, in particular whether this was due to problems encountered by existing advisory bodies set up for the financial services industry. The Under Secretary for Financial Services and the Treasury ("USFST") said that she disagreed with Mr SHEK's comment. As recommended by the PTF, Hong Kong was in need of an advisory body which could bring about cross-sectoral collaboration and coordinate views of various segments of the financial market. FSDC could serve to advise the Government on strategies and measures to expand the scope of the financial markets and enhance the competitiveness of Hong Kong.

26. Mr Abraham SHEK considered it contradictory for FSDC to assume an advisory role on one hand, and be set up as a company limited by guarantee on the other. Sharing a similar view, Mr James TIEN enquired about the reference to similar organizations in Hong Kong which had been set up as a company limited by guarantee.

27. USFST said that there were no inconsistencies between setting up FSDC as a company limited by guarantee and funding its operation from public resources as such a model was not entirely new to Hong Kong. She said that the Financial Dispute Resolution Centre ("FDRC") was also a non-statutory body which was set up as a company limited by guarantee with set-up costs and operation costs funded by the Government, HKMA and the Securities and Futures Commission ("SFC") for the first three years. Similarly, the Investor Education Council ("IEC") was established as a company solely-owned by SFC.

28. Dr KWOK Ka-ki said that the public was confused about the status of FSDC, as there had been different messages as whether FSDC would be set up as a statutory body, a civil organization ("民間組織") or a company limited by guarantee. Dr KWOK asked if this was due to changes in the position of the

Chief Executive ("CE") on the matter. C/FSDC said that after announcement of the establishment of FSDC, in response to a reporter's enquiry whether FSDC was a government organization, she had made the remark that FSDC was a civil organization ("民間組織"). She noted that the remark had given rise to confusion about the nature of FSDC, and had apologized to the public in this regard.

29. Mr SIN Chung-kai noted that while the Economic Development Commission ("EDC") and the FSDC were both new advisory bodies set up by the Government in CE's policy address for pursuing Hong Kong's further development, there was no criticism about the role of EDC. He remarked that this might probably because EDC's Chinese name "經濟發展委員會" had clearly conveyed its status to the public. Mr SIN asked if FSDC would consider changing its name to better reflect its advisory role, i.e. to change the rendition "局" ("Council") to "諮詢委員會" ("Advisory Committee") in the Chinese name so as to address the public concern. C/FSDC said that FSDC had taken into account the names of other advisory bodies set up by the Government. It had been observed that the rendition "局" was used as the Chinese names of the English equivalent of "policy bureau", "authorities" (e.g. HKMA and the Airport Authority Hong Kong ("AAHK")), "boards" (e.g. Employees Retraining Board), as well as "councils" (e.g. the Hong Kong Trade Development Council ("HKTDC"), Hong Kong Productivity Council, Vocational Training Council, Financial Reporting Council ("FRC"), Hong Kong Film Development Council), covering both statutory and advisory bodies. C/FSDC also pointed out that the University Grants Committee, which advised the Government on the development and funding needs of higher education institutions, was not a statutory body and simply adopted the rendition "委員會" in its Chinese name. As there was no standardized or established practice within the Government in determining the names of the advisory bodies, FSDC considered it appropriate to continue using the rendition "局" in its Chinese name.

30. Mr James TO said that, as FSDC was simply an advisory body that would not execute government policies, and given the small size of its staff establishment which would primarily responsible for policy research work, he did not see any practical need for FSDC to be set up as a company limited by guarantee for the benefits of good governance and greater flexibility in operation. He also disagreed with the suggestion that FSDC should be made a statutory body as this would not help remove the controversies over the role and operation of FSDC. Mr TO suggested that, to allay public concern, FSDC should withhold the proposal to set up a company limited by guarantee and should make clear this decision to the public as soon as possible. C/FSDC advised that taking into account the wide public concern, and the priorities of FSDC, FSDC members agreed that at the current stage, they should not focus

their efforts in pursuing the proposal to set up the company in question, nor was there any timetable for the proposal in the near future. She assured members that, if FSDC ultimately resolved to set up a company for its operation, it would announce the decision to the public in a timely manner.

31. Mr CHAN Kin-por agreed to the need to set up FSDC for studying measures for the development of the local financial services industry. He pointed out that, after the Lehman Brothers incident, the regulators had tightened the regulatory regime, which had made it difficult for the industry to sustain their business. While FSDC was established as an advisory body, he believed that the role and work plan of FSDC could be reviewed and fine-tuned when appropriate and necessary.

32. Mr Andrew LEUNG concurred with the mission of FSDC to promote the development of the financial services industry. He considered that FSDC should focus on carrying out its primary functions in the initial years of establishment and leave the issue of setting up the body as a company limited by guarantee to a later stage. He took the view that, with proven performance and a better understanding of the work of FSDC over the years, there would be greater room for discussion and consideration of its development in future.

33. C/FSDC agreed that FSDC should give priority to commencing studies for sustaining and enhancing Hong Kong's competitive edges, in particular, to leverage on the staunch support of the Mainland and engage Hong Kong globally. In this connection, she was pleased to inform members that a number of overseas counterparts had already expressed interest to establish close ties and collaborate with FSDC in future.

34. Mr Abraham SHEK queried if there was a hidden agenda to develop FSDC as an investment company similar to the Temasek Holdings owned by the government of Singapore, for the purpose of holding government assets (e.g. government shares in MTRCL) and making investments. Mr NG Leung-sing opined that, as FSDC did not have any funding for making investment at this stage, it was premature to consider whether it would develop along the line of the Temasek Holdings. Dr KWOK Ka-ki sought clarification whether FSDC was intended to facilitate the setting up of a sovereign fund, and whether FSDC would seek and accept private donations. C/FSDC replied in the negative, emphasizing that the role of FSDC was essentially to enhance, elevate and champion the competitive position of Hong Kong as an international financial centre. It was not the intention of FSDC to set up a sovereign fund, nor to secure private donations at the current stage.

Reference to overseas practice

35. Mrs Regina IP noted that the suggestion to set up FSDC to promote the financial services industry of Hong Kong in the Mainland and overseas had made reference to similar overseas experiences, such as the TheCityUK in the United Kingdom ("UK"). Mr James TIEN enquired in what ways FSDC was similar to TheCityUK. Mr Dennis KWOK remarked that FSDC was distinctly different from TheCityUK as the latter was essentially an industry trade union which did not include any government officials as members.

36. C/FSDC said that TheCityUK, which had been established for about three years, continued the work of the International Financial Services London and the Financial Services Advisory Board of the UK Trade and Investments, both of which had merged with TheCityUK. The mission of FSDC had made reference to the objectives of TheCityUK to promote the UK-based financial and professional services industry, and advocate the UK as a world class centre for these services. Both FSDC and TheCityUK were supported by the respective governments although there were differences in their funding or resources arrangements. Due to its longer history and unique background of migration from predecessor organizations, TheCityUK was relatively mature in development when it was set up. C/FSDC further pointed out that TheCityUK was a company limited by guarantee. As regards the differences, unlike The CityUK which was largely an industry-driven membership body, FSDC was an advisory body to the Government and did not collect fees from its members. As FSDC was still at an early stage of development, it did not intend to operate along the line of TheCityUK to collect fees for an income.

Division of work between FSDC and other government agencies

37. Mrs Regina IP enquired about the division of work among FSDC, FSTB, HKMA and HKTDC in relation to the promotion of Hong Kong's financial services markets and industry. USFST explained that FSTB, HKMA and HKTDC were undertaking initiatives for the promotion of the financial services industry but with different emphasis. As officers were seconded from FSTB, HKMA and HKTDC to the FSDC Secretariat, FSDC could identify and avoid overlap in the promotional initiatives.

38. Mr Kenneth LEUNG noted that a number of trade organizations, such as HKAB and the Hong Kong Investment Funds Association ("HKIFA"), were among the stakeholders in the financial services sector. As FSDC assumed the role to gauge the views from the industry, Mr LEUNG asked whether the trade organizations concerned would need to provide their views through FSDC in future. C/FSDC said that FSDC was not the sole channel for market participants and the trade organizations to express their views to the

Government, nor was it compulsory for the views to be conveyed through FSDC in order to be heard and considered by the Government.

Supporting small and medium-sized securities firms

39. Mr Christopher CHEUNG expressed support in principle to the establishment of FSDC. He said that the small and medium-sized securities firms were among those parties that had put forth to CE the suggestion to set up FSDC, and the local financial services industry in general held a high expectation of FSDC. Mr CHEUNG relayed the concern of the small and medium-sized securities firms about measures to enhance their competitiveness and ensure a level playing field between these firms and the large financial institutions in grasping a share in the development of the local market and accessing business opportunities in the Mainland. He pointed out that some of the rules and regulations under the existing regulatory regime were over stringent and in need of review to provide a viable operating environment for the small and medium-sized securities firms. Mr CHEUNG hoped that the committees of FSDC would take note of these concerns in taking forward initiatives to develop the financial services markets.

40. Sharing Mr Christopher CHEUNG's view about the difficulty for small and medium-sized enterprises ("SMEs") to access the Mainland market, Mrs Regina IP suggested that FSDC should study measures to assist the SMEs to grasp business opportunities in the Mainland market, for instance, to ride on the recent initiatives of the Mainland to develop the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone. Mr NG Leung-sing noted that SMEs were keen about how FSDC could assist them in their business development. As large enterprises were tapping business opportunities across the border, this might leave room for SMEs to sustain and expand their operation in the local market. Mr NG suggested that FSDC should undertake in-depth studies along this direction and examine possible measures to balance the interests of SMEs and the larger enterprises in both local and Mainland markets.

41. C/FSDC said that FSDC recognized the needs of SMEs and the efforts of the industry players in the development of the financial services sector. FSDC would broadly consult the relevant stakeholders, including the securities sector, to explore business opportunities. To this end, each committee of FSDC would comprise representatives from various sub-sectors with a view to achieving a broad-based representation to serve the interests of the whole financial market, and FSDC would be mindful of the interests of both SMEs and large enterprises. As regards the Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone, FSDC would closely

monitor the development and identify potential business opportunities for Hong Kong market participants.

Measures to promote Hong Kong as an international financial centre

42. Referring to the experience of Singapore, Mr CHAN Kin-por pointed out the importance to develop headquarters economy in enhancing the competitiveness of Hong Kong. He considered that attracting multinational companies to set up their regional headquarters in Hong Kong would give impetus to the economy by creating new business opportunities and supporting employment. The job training and career development made available by multinational companies would be valuable to the local workforce, in particular the younger generation, by enhancing their global or regional exposure. Mr CHAN considered that, to promote headquarters economy, tax concessions and other incentives to attract establishment of businesses should be introduced. In view of the long-term economic benefits, he considered it worthwhile to exercise some flexibility in the tax policy by granting short-term tax concessions to multinational companies intending to establish their regional headquarters in Hong Kong if their investment and job creations reached a certain threshold. Mr CHAN urged FSDC to study the matter and work out options for further discussion by the business sector. C/FSDC observed that the regional counterparts of Hong Kong were developing their financial services industry at a fast pace. In order not to lose out to the competitors, Hong Kong must continue to ride on its edges to enhance the scope and standard of its financial services. She assured members that FSDC members would be keen to explore the strategies for developing headquarters economy and come up with constructive recommendations.

43. The Chairman said that Members belonging to the Democratic Alliance for Betterment and Progress of Hong Kong supported the setting up of FSDC. She observed that the regulators and FSDC would complement each other in their work with the former serving as gatekeepers of regulatory regimes and FSDC providing advice on the enhancement and development of the local financial services sector. The Chairman said that while she was aware of the challenges facing FSDC in taking forward its work, she urged FSDC to overcome the hurdles, ensure adequate manpower provision, and conduct thorough consultation on various matters, including development of headquarters economy, promoting offshore RMB business and creating a level playing field for SMEs, and come up with recommendations in the interests of the entire financial services industry. C/FSDC took note of the suggestions.

Work plan and target deliverables of FSDC

44. Dr CHIANG Lai-wan enquired whether FSDC would set targets for its work, for instance, raising the share of GDP accounted by financial services from the current level of 16%. She suggested that FSDC should lay down clear objectives and deliverables to ensure undertaking of its mission and delivery of the targets. Mr Kenneth LEUNG shared a similar view and suggested that FSDC should draw up a one to two-year work plan setting out specific targets of deliverables. Mr NG Leung-sing opined that, as FSDC was newly established, there was a need to provide sufficient time for it to develop a work plan and discharge its functions in a progressive manner. As a modest start, he considered that FSDC could make available to the public an outline of the subject matter it planned to study or deliberate so that interested members of the public could provide their views and suggestions timely. He also suggested that FSDC should draw up a timetable in reporting its work progress and outcomes of the studies or discussions.

45. Mr Dennis KWOK said that, while the PTF's report had laid down the broad directions for the development of FSDC, it could not reflect the concrete details of FSDC's work. Given the unclear role and uncertainties in the form of operation of FSDC, Mr KWOK suggested that, similar to the practice of the Hong Kong Tourism Board, Urban Renewal Authority and AAHK, etc., FSDC should draw up a development plan and a work plan to apprise the public of its work.

46. C/FSDC said that, while it might not be practicable to set quantifiable targets to assess effectiveness of FSDC's work, FSDC would endeavour to coordinate the views of the industry and advise the Government on suitable strategies and measures to strengthen and expand the scope of the financial services market. As regards the timetable for delivering work outcome, C/FSDC said that so far FSDC had only held one meeting on 22 January 2013. As issues surrounding the role and operation of FSDC had become clear, FSDC would commence its work as soon as possible, and report the progress in the near future. She advised that FSDC would prepare a work plan in due course, taking into account the views and suggestions collated from its five committees.

47. The Chairman observed that whether FSDC's recommendations would be pursued depended on the importance and priority attached to them by the Government. She asked whether the Government would study the recommendations of FSDC promptly and, if the recommendations would be adopted, whether the Government would draw up a timetable for their implementation. USFST said that the Administration treasured the recommendations to be made by FSDC. As the recommendations would be put

forth to the Government after thorough consultation among FSDC's members and had reflected the industry's views, she believed that the Government would take them into consideration seriously.

Membership of FSDC

48. Mr Abraham SHEK expressed concern that the 22 members currently appointed to FSDC did not include representatives from small and medium-sized financial institutions, and queried if FSDC's representation was broad enough in gauging the industry's views. The Chairman considered that the membership size of FSDC should be increased, and requested FSDC to identify more stakeholders on a broader basis for participation in FSDC. C/FSDC said that FSDC had broad representation from the financial industry. She added that FSDC had approached, amongst others, Mr Christopher CHEUNG for candidates. While only 22 members were appointed at this stage, FSDC was identifying more representatives as appropriate, including those from small and medium-sized financial/banking institutions as members of its committees. .

49. Mr Kenneth LEUNG expressed concern that none of the FSDC members came from the financial regulators (i.e. HKMA and SFC). C/FSDC said that FSDC was tasked to coordinate views of the industry. Nevertheless, FSDC would maintain close liaison with the regulators on issues of mutual concern and seek ongoing communications with them. She observed that the regulators supported the establishment of FSDC. Mr LEUNG considered that, to avoid giving an impression of favouritism, each of the major trade organisations of the financial sector (e.g. HKAB and HKIFA) should be invited to make nomination for appointment of members to FSDC in future. C/FSDC said that members of FSDC were appointed on the basis of their abilities and expertise to successfully contribute to its work, taking into account the candidates' vision, achievements, reputation, industry network and understanding of the financial services market. All members of FSDC would be broadly representative of the industry, and treated equally and fairly.

Funding of FSDC

50. Mr Kenneth LEUNG noted that at the initial stage, the FSDC Secretariat would comprise a skeleton team with secondments from FSTB, HKMA, SFC and HKTDC. As the staff cost and other expenditures might grow along with development of FSDC, and to enhance its transparency and accountability, he suggested that the budget of FSDC should form part of FSTB's budget and incorporated into the Estimates for LegCo's approval. USFST said that, currently, the staff deployed from FSTB was only on secondment to the FSDC Secretariat. The future expenditures of FSDC would be reflected in the

Estimates commencing from the financial year 2013-2014 which was subject to LegCo's scrutiny.

Motions

51. The Chairman informed the meeting that some members had put forward three motions on this item, the wordings of which were tabled at the meeting. To facilitate members' consideration of the overall arrangement for the three motions, the Chairman read out each motion in turn in accordance with the order of their receipt by the LegCo Secretariat.

(a) *The first motion, moved by Mr Dennis KWOK and seconded by Mr Kenneth LEUNG:*

"本委員會要求政府必須以法定機構模式設立和營運金融發展局。"

(Translation)

"That this Panel requests that the Government should set up and operate the Financial Services Development Council as a statutory organization."

(b) *The second motion moved by Mr Kenneth LEUNG and seconded by Mr Dennis KWOK:*

"本委員會要求政府在金融發展局未成立為法定機構之前，易名為"金融發展諮詢委員會"。"

(Translation)

"That this Panel requests that the Government should, before the establishment of the Financial Services Development Council as a statutory organization, change the Chinese name of the Council to 金融發展諮詢委員會. "

(c) *The third motion moved by Mr Christopher CHEUNG:*

"鑒於公眾對金融發展局有很多疑慮，本會建議將金融發展局改為政府的諮詢機構，並研究將來發展成為法定機構的可行性。"

(Translation)

"That, given the doubts and worries of the public about the Financial Services Development Council ("FSDC"), this Panel suggests that the FSDC be made an advisory body of the government instead and studies be conducted on the feasibility for it to develop into a statutory body in the future."

52. The Chairman considered that all three proposed motions were directly related to the agenda item under discussion but the first and the third motions were contradictory to each other. As such, if the first motion was passed, the meeting would not proceed to deal with the third motion.

53. Mr Abraham SHEK said that he did not consider the first and the third motions mutually exclusive. While the first motion urged that FSDC be set up and operated as a statutory body, the wording did not indicate the timing for implementing the suggestion. The third motion also did not specify when FSDC should be set up as a statutory body if the study in question recommended so. The Chairman ruled that, as the first motion urged that FSDC "must be" set up as a statutory body, it would not be compatible with the third motion even though the timing of the proposed arrangements were not specified in both motions. Members agreed with the Chairman's ruling on the motions and agreed to proceed dealing with the motions.

54. The Chairman put Mr Dennis KWOK's motion to vote. Of the members present, two members voted for the motion and nine members voted against the motion. The Chairman declared the motion moved by Mr KWOK was negatived. The Chairman then put Mr Kenneth LEUNG's motion to vote. Of the members present, three members voted for the motion and eight members voted against the motion. The Chairman declared the motion moved by Mr LEUNG was negatived. The Chairman put Mr Christopher CHEUNG's motion to vote. Of the members present, seven members voted for the motion and four members voted against the motion. The Chairman declared the motion moved by Mr CHEUNG was carried.

(*Post-meeting note*: The Administration's response to the motion was circulated to members vide LC Paper No. CB(1)684/12-13(01).)

55. In response to Mr Abraham SHEK's request, the Chairman invited the Administration/FSDC to report the progress of FSDC's work to the Panel on a regular basis in future.

VI Tax Information Exchange Arrangements

(LC Paper No. CB(1)484/12-13(05) — Administration's paper on "Exchange of Tax Information Arrangements"

LC Paper No. CB(1)484/12-13(06) — Background brief on tax information exchange arrangements prepared by the Legislative Council Secretariat)

Presentation

56. With the aid of a powerpoint presentation, the Permanent Secretary for Financial Services and the Treasury (Treasury) ("PS(Tsy)") briefed members on the Administration's policy to expand Hong Kong's network of comprehensive avoidance of double taxation agreements ("CDTAs"), the justifications for the legislative proposals to enhance the exchange of information ("EoI") arrangements for tax purposes, including the recommendation of the Global Forum on Transparency and Exchange of Information for Tax Purposes ("the Global Forum") of the Organization for Economic Cooperation and Development ("OECD") for Hong Kong to put in place a legal framework for entering into Tax Information Exchange Agreements ("TIEAs"). In order to enhance the EoI arrangements in respect of tax types and limitation on disclosure under CDTAs and to enable Hong Kong to enter into TIEAs with other jurisdictions where necessary, the Administration proposed to amend the Inland Revenue Ordinance (Cap. 112) ("IRO") to the effect that –

(a) arrangements could be made with governments of territory outside Hong Kong not only for the purpose of affording relief from double taxation in relation to income tax and any tax of a similar character imposed by the laws of that territory, but also for the purpose of exchanging information in relation to any tax imposed by the laws of Hong Kong or the territory concerned;

(b) the Inland Revenue Department ("IRD") could exercise its power to obtain information relevant to the proposed enhanced EoI under CDTAs and TIEAs;

(c) IRD's information gathering power applied not only to information that was in physical possession of a person but also information that was in his control; and

(d) the Commissioner of Inland Revenue ("CIR") could disclose information in response to an EoI request if he was satisfied that such information related to tax assessments in respect of any period after the date on which the relevant CDTA or TIEA came into operation.

57. PS(Tsy) advised that the Administration's plan was to introduce the relevant amendment bill into LegCo in April 2013. She emphasized that, as the Global Forum would meet in September 2013 to consider the Phase 2 peer review report on Hong Kong, it was critical for Hong Kong to have in place the legal framework for TIEAs in mid-2013 before the review report was finalized by the Global Forum.

(*Post-meeting note*: The notes of the powerpoint presentation (LC Paper No. CB(1)525/12-13(01)) (Chinese version only) were issued to members vide Lotus Notes e-mail on 4 February 2013.)

Discussion

Standard for EoI arrangements

58. Mr James TO said that a stringent and prudent approach should be taken to consider any enhancement in the EoI arrangements having regard to the great differences between the tax regime of Hong Kong and those of other jurisdictions in terms of tax types and rates. He expressed concern that relaxing the EoI arrangements would risk undermining the competitiveness of Hong Kong's simple tax regime in attracting foreign investment. The workload of IRD would also inevitably increase due to the need to search and exchange more information in response to treaty partners' requests under the expanded EoI regime. Emphasizing the need to protect the interests of Hong Kong, Mr TO urged that the Administration should not be too proactive in bringing its EoI arrangements on par with the international standard as long as the situation did not give rise to any critical problem, such as imposition of unilateral sanctions on Hong Kong or negative impact on the diplomatic relations between Hong Kong and other jurisdictions. Sharing Mr TO's view, Mr SIN Chung-kai opined that there was no pressing need for Hong Kong to

catch up closely with or even surpass other jurisdictions in the EoI regime unless all other major jurisdictions had adopted the same standard in question.

59. Mr Jeffrey LAM expressed support for the proposal. On the issue of how far Hong Kong should keep abreast of the international standard in tax transparency, he opined that the Administration should give similar consideration in other policy areas in a consistent manner.

60. Referring to the increasing aspiration on the international front to enhance tax transparency, PS(Tsy) said that there was a genuine need for Hong Kong to take the minimum necessary approach to enhance the EoI arrangements such that Hong Kong would not run the risk of being labeled as an uncooperative jurisdiction because of its restrictive position in the area of tax types and limitation on disclosure and its inability to enter into standalone TIEAs. The Deputy Secretary for Financial Services and the Treasury (Treasury) 2 ("DS(Tsy)2") said that it was not the intention of the Administration to overtake other tax jurisdictions in meeting the international obligation in the area of tax transparency. She pointed out that the OECD had approved updates to its EoI article in its Model Tax Convention in 2004 and 2012, and most of Hong Kong's neighbouring jurisdictions had already adopted the latest version. It was thus crucial for Hong Kong to enhance its EoI arrangements so that it would not lag behind other jurisdictions.

61. Mr Kenneth LEUNG said that while he had reservation over the legislative proposals when they were discussed at the forum of the Joint Liaison Committee on Taxation, he was now open-minded to the proposal after considering the details set out in the Administration's paper (LC Paper No. CB(1)484/12-13(05)). He enquired about the difference, if any, between the EoI arrangements in the CDTAs/TIEAs under the legislative proposals and the latest international standard in respect of the EoI arrangements. The Deputy Commissioner of Inland Revenue (Technical) ("DCIR(T)") advised that the latest international standard for EoI arrangements was reflected in the 2012 version of EoI article of OECD's Model Tax Convention and its Commentary. Hong Kong would only meet the minimum requirements even if the legislative proposals were passed. For instance, Hong Kong would still not entertain requests for tax information relating to retrospective tax assessments; tax examinations abroad; and assistance in the collection of taxes which were considered as desirable in the 2012 version of the OECD's Model Tax Convention and its Commentary.

Limitation on disclosure

62. Mr James TO expressed objection to relax the current limitation on disclosure. Mr SIN Chung-kai doubted the practicability to trace and

exchange tax information that was generated a long time ago, say 10 or 20 years before the effective date of the relevant CDTA/TIEA agreements. He suggested that, instead of relaxing the disclosure limitation, treaty partners should make preparation in the transitional period before the CDTA/TIEA took effect, such that the information to be exchanged for tax purposes would only cover those generated after the effective date of the relevant provisions of CDTA/TIEA.

63. DCIR(T) and DS(Tsy) said that the current proposal still upheld the policy of no retrospectivity for EoI as it only relaxed the limitation on disclosure slightly by allowing CIR to disclose information in response to an EoI request only if he was satisfied that such information related to tax assessments in respect of any period after the date on which the relevant CDTA/TIEA came into operation. For instance, if the deed of assignment of a property transaction under tax assessment was generated after the effective date of a CDTA, whereas the relevant sale and purchase agreement was signed prior to this date, the latter would also be regarded as information relevant to the tax assessment as it in fact related to the same property transaction. DS(Tsy) said that the Administration was well aware of members' concerns about the disclosure issue, and the current proposal was only meant to give CIR more flexibility to meet CDTA/TIEA partners' practical requirements for information that was generated prior to the effective date of the relevant provisions if the information was foreseeably and reasonably relevant to tax assessments of periods after the effective date of the relevant provisions .

Collection of information in respect of EoI request

64. Mr WONG Ting-kwong enquired whether the taxpayer concerned would be informed of the request for tax information by other jurisdictions under CDTAs or the future TIEAs. Referring to the existing notification system under the Inland Revenue (Disclosure of Information) Rules (Cap. 112 sub. Leg. BI) ("the Disclosure Rules"), DCIR(T) said that CIR was required to inform the taxpayer concerned of the disclosure request from CDTA or future TIEA partners. The taxpayer might request a copy of the information that CIR was prepared to disclose, and amend the information if it was factually incorrect. The Disclosure Rules also provided for a review system in handling appeals, whereby the taxpayer in question might request the FS to direct the CIR to make the amendments to the information to be disclosed.

65. Mr WONG Ting-kwong enquired about the actions IRD would take if the requested information had to be collected from other departments/agencies of the Government (e.g. Hong Kong Police Force, Hong Kong Correctional Services, Immigration Department, Land Registry, Companies Registry). DCIR(T) said that Hong Kong was obliged to collate information from other

local departments/agencies, if necessary, for supply to the contracting party in respect of an EoI request.

66. Mr Jeffrey LAM relayed the worries of SMEs about potential impacts of the collection and exchange of information relating to their business operations and how to ensure the information exchanged would only be disclosed to the tax authorities concerned and solely for tax purposes. PS(Tsy) said that the Administration would continue to adopt existing highly prudent safeguards to protect taxpayers' privacy and confidentiality of information in the exchanges, as set out in paragraph 12 of the Administration's paper. The safeguards would be included in the texts of CDTAs/TIEAs. DS(Tsy)2 supplemented that if the treaty partners were considered to have violated their obligations, including the confidentiality requirements, Hong Kong would,if warranted, take necessary action against the treaty partner in question, including termination of the relevant CDTA/TIEA. In response to the enquiry of Mr LAM, DS(Tsy)2 advised that if a treaty partner wished to disclose the information requested from IRD to a third jurisdiction, the treaty partner must seek the consent from IRD in advance.

Conclusion

67. Concluding the discussion, the Chairman said that the Administration should take into account members' views and concerns when finalizing the amendment bill. She said that the relevant issues would be pursued by the bills committee if one was to be formed.

VII Budget of the Securities and Futures Commission for the financial year of 2013-2014

(LC Paper No. CB(1)484/12-13(07)	—	Administration's paper on "Securities and Futures Commission Budget for the Financial Year 2013-14"
LC Paper No. CB(1)518/12-13(01)	—	Securities and Futures Commission's written response to the enquiries raised by Hon Kenneth LEUNG on the regulation of financial adviser in carrying out regulated activities at the meeting on 7 January 2013

LC Paper No. CB(1)518/12-13(02) — Securities and Futures Commission's written response to the enquiries raised by Hon Mrs Regina IP on the impact of the acquisition of the London Metal Exchange Holdings Limited by the Hong Kong Exchanges and Clearing Limited on the Hong Kong Mercantile Exchange at the meeting on 7 January 2013

LC Paper No. CB(1)484/12-13(08) — Background brief on the annual budgets of the Securities and Futures Commission prepared by the Legislative Council Secretariat)

Presentation

68. The Deputy Secretary for Financial Services and the Treasury (Financial Services) 1 ("DS(FS)1") said that the Administration was studying in detail SFC's proposed budget for the financial year 2013-2014. The Administration noted that SFC had projected a deficit in its budget, and as in the past years, it had not requested appropriation from LegCo. It was also noted that SFC had drawn up the budget with due regard to prudent management and control of expenditure.

69. At the invitation of the Chairman, the Chairman, SFC ("C/SFC") briefed members on the proposed budget. He highlighted the following points:

(a) There would be an estimated operating deficit of about $435 million for 2013-2014, as a result of projected low market turnover, and a conservative approach was adopted for income estimation, having regard to uncertainties in the global economy, especially in the US and European markets;

(b) SFC would continue to waive the annual licence fee in 2013-2014, a measure which was implemented from 1 April 2012 for two years. The measure had so far benefited more than 40 000 intermediaries;

(c) SFC had carefully considered whether to reduce its levy rate. Bearing in mind the projected operating deficit for 2013-2014, the levy as a primary source of SFC's income, the limited benefits of levy reduction for investors, SFC considered it not an appropriate time to lower the levy rate which had been adjusted downwards twice in the past (i.e. in 2006 and 2010). Nevertheless, SFC would conduct a detailed review of its levy and reserves again towards the end of 2013 taking into account the prevailing market conditions, the expected income source requirements and financial projections;

(d) SFC's accumulated reserves would continue to enable SFC to discharge its duties effectively in a difficult environment with confidence and without resorting to government funding;

(e) Having regard to its primary functions and the continued market uncertainties, SFC decided not to acquire an office property of its own for the time being, given that the lease of the current SFC office at the Cheung Kong Center ("CKC") would last for at least five years;

(f) New developments in the local and international financial environment had increased the volume and complexity of SFC's regulatory work. It was imperative for SFC to be sufficiently funded and staffed to deal with the new challenges. Provisions for new headcount request was included in the budget, principally in the areas of enforcement, intermediaries supervision and investment products; and

(g) SFC would continue its funding and support to external parties whose objectives and functions aligned with those of SFC. For instance, apart from IEC, it would collaborate with the Hong Kong Securities and Investment Institute to promote education of market participants and the investing public.

Discussion

Manpower resources

70. Mr Dennis KWOK noted that SFC's budget for 2013-2014 included a provision for an average 5.5% pay increase for SFC staff and a "special pay adjustment" provision of $14.04 million for high performing staff with retention risk. He enquired whether SFC had difficulty in recruiting quality staff, especially in the area of enforcement. He was concerned that due to

insufficient staffing, SFC might need to incur additional expenses for engaging legal and other professional services from outside.

71. C/SFC and the Chief Executive Officer, SFC ("CEO/SFC") admitted that it was difficult for SFC to retain and recruit staff, in particular in the areas of legal services, compliance and enforcement, in face of the keen competition for this expertise in the financial services industry, and the more attractive remuneration packages offered by the private sector. A pay survey conducted by SFC showed that the total compensation of around 75% of SFC staff was below the average market median, and 44% below the bottom quartile threshold. CEO/SFC added that the management of SFC had discussed with its pay consultants on the recruitment strategy, with a view to striking a balance of considerations of the market pay level, the unique career rewards for service in SFC, as well as a sustainable budget. Notwithstanding the difficulty to recruit staff, to enhance efficiency, SFC had all along limited the extent of outsourcing to external professionals, and tried to accomplish its work with in-house expertise as far as possible.

72. Mr SIN Chung-kai noted that SFC proposed a net increase of 47 full-time posts in the manpower plan for 2013-2014, of which 12 posts would be deployed to step up SFC's core enforcement capacity. He was concerned whether the additional staff would be sufficient to cope with the increase in caseload of SFC, and capable of meeting time pledges in completing investigation on cases.

73. C/SFC said that enforcement was an important part of SFC's regulatory function, apart from the issuance of compliance circulars, market monitoring and identification of misconduct. He pointed out that the enforcement team of SFC had been facing immense pressure from the increasing caseload. New cases opened for SFC investigation had increased by 40% over the past 12 months whereas litigation decisions on active cases had gone up by 17%. CEO/SFC supplemented that the number of trading enquiries made by SFC in relation to unusual pattern of market behavior had risen by 39% whereas the number of on-site inspections had increased by 18% in the past year. He said that the increasing workload was not just attributed to more number of cases lodged with SFC but also greater complexity of the cases as a result of new developments in the financial services market, which had implications on the investigation time.

74. Mr SIN Chung-kai suggested that, given its large reserves, SFC should consider strengthening its manpower requirements beyond the number proposed in its budget, in order to ease the workload. C/SFC explained that apart from those posts for placement of graduate trainees, the bulk of the

additional posts in the new headcount request was at the senior level. While there was a need to hire additional staff for carrying out enforcement, it was just as essential to recruit the suitable type of people from the market. That said, SFC remained conscious of its accountability and exercised discipline in formulating the budget, whilst ensuring that it was adequately staffed to carry out enforcement efficiently.

75. Mr CHAN Kin-por noted that SFC requested a total of nine additional headcount for its Policy, China & Investment Product Division to meet regulatory challenges and increase in workload, including the increasing volume of Investment-Linked Assurance Schemes ("ILAS") applications. Mr CHAN relayed the concerns from the insurance industry that the time taken by SFC in vetting ILAS applications was unduly long, i.e. about nine months to one year. He urged SFC to streamline and standardize the procedures where appropriate and strengthen the training of new staff to enhance their capability in processing the applications. He also suggested SFC to organize talks/seminars for the insurance industry on the approval requirements. CEO/SFC said that SFC had been exchanging views with HKIFA recently on these areas to enhance the efficiency of processing ILAS applications. The processing time should take into account the complexity of the product in question, withdrawal/re-submission of applications on the applicant's own accord in some cases, and affording due consideration to ensure sufficient investor protection.

76. The Chairman enquired how the additional headcounts for 2013-2014 had been worked out. She expressed concern whether the headcount request was aimed to increase the estimated expenditures and reduce the reserves only for the sake of budgetary presentation. C/SFC said that extra manpower was genuinely needed to meet the new demand and challenges in the regulatory work of SFC having regard to new international regulatory initiatives and changes in the domestic markets. CEO/SFC elaborated on some of the latest trends, including liberalization of RMB, the development of Hong Kong as a premier asset management centre, new developments in overseas rules and regulations as advocated by the Group of Twenty Finance Ministers and Central Bank Governors, and the expanded business activities of the HKEx. These were among the developments that had led to a greater complexity in the regulatory and enforcement work of SFC. CEO/SFC emphasized that the level of reserves was not a consideration in preparing the budget or requesting for the new headcounts.

Levy rate

77. Mr James TO pointed out that under section 396 of the Securities and Futures Ordinance (Cap. 571) ("SFO"), SFC shall consult the FS with a view to recommending to the Chief Executive-in-Council that the rate or amount of the

levy be reduced when its reserves were more than twice its estimated operating expenses for the financial year. As SFC would have a reserve of $7,237.6 million by 31 March 2013, which was 5.6 times of the projected expenditure of 2012-2013 ($1,291.71 million), the threshold for reducing the levy rate was reached. In particular, now that SFC had completed its office relocation to the CKC premises and the renovation and equipment costs had decreased, there should be ample room for levy adjustment. Mr TO considered that the fact that SFC had waived its licensing fee on intermediaries was not a justification for it not to consider reducing the levy rate, because the waiver was a measure catering the licensed intermediaries only, whereas the levy was paid by the investors. He insisted that SFC should exercise its statutory obligation, irrespective of the benefits of levy reduction for investors.

78. Mr Christopher CHEUNG considered that, from the perspective of the securities industry, reducing the SFC levy rate would lower the investment cost for the ordinary investors and thus enhance the business opportunities for securities firms, especially the SMEs.

79. C/SFC said that SFC had conducted a detailed review of its reserves and levy in August 2012 in response to members' request to reduce the levy rate made at the Panel meeting on 6 February 2012. It should be noted that the market conditions had remained volatile. Due to lower-than-expected market activities, there was a projected deficit of $232.13 million for 2012-2013, against a surplus of $145.12 million in the original budget for the year. The average daily turnover was lowered from $77 billion/day in the original estimates for 2012-2013 to $50 billion/day in the revised estimates. In view of the projected budget deficit of $435.16 million for 2013-2014, and the deficit might continue for some years ahead, SFC considered it prudent that the reserves be carefully used in order to cover the "rainy days". C/SFC undertook that SFC would conduct a review of the reserves and levy again towards the end of 2013. In the meantime, SFC would continue to manage its finances prudently. CEO/SFC added that the board of SFC had discussed in detail the issue of levy reduction, and concluded that it was not the appropriate time to reduce the levy rate having regard to market uncertainties and the operating deficit. He believed that SFC would be better placed to consider the reduction when SFC's operation achieved break-even or surplus.

80. Mr James TO expressed strong dissatisfaction about the inaction of SFC over the subject of levy reduction in spite of the request from members at the Panel meeting last year. Mr TO took the view that the requirement under section 396 of SFO implied that a reserves level that was twice of its estimated operating expenses was basically healthy. A reduction in the current levy rate would not undermine the healthy financial position of SFC. He urged SFC to discharge its statutory obligation pursuant to section 396 of SFO. Mr TO said that he might consider initiating a judicial review of the matter if SFC

remained reluctant to reduce the levy rate. DS(FS)1 said the Administration noted that the levy was the principal source of income for SFC. The current levy rate had reached a rather low level after two rounds of previous reductions. In addition, a two-year annual licence fee holiday was offered last year until early 2014. This benefited intermediaries directly and SFC had undertaken to consider it nearer the time. She noted that SFC would also closely monitor the market developments and conduct a detailed review of its levels of reserves and levy rate by the end of 2013.

Investment income of SFC

81. Referring to the income and expenditure statement of SFC, Mr Kenneth LEUNG noted that the investment income for 2013-2014 was $93 million. He sought the details of the income and the management party for the investment. C/SFC emphasized that SFC managed its surplus funds very prudently by making investment primarily in government bonds with very high ratings. The investment of SFC's assets was managed by in-house staff in consultation with external investment advisers. He informed members that SFC had set up an Investment Committee (chaired by C/SFC) to task with duties including improvement of the investment return. In reply to Mr LEUNG's further enquiry, C/SFC said that SFC did not place its surplus with EF for investment by HKMA.

Funding to Investor Education Centre and Financial Dispute Resolution Centre

82. Mr Kenneth LEUNG noted that a funding of $51.2 million and $3.5 million was committed to IEC and FDRC respectively in the 2013-2014 budget. He enquired about the background for these funding arrangements, and how funds provided to IEC would be utilized. CEO/SFC said that IEC, a subsidiary of and fully funded by SFC, was established for the purpose of enhancing investor education in Hong Kong. As regards the funding to FDRC, DS(FS)1 said that SFC shared the operation costs of FDRC with the Administration and HKMA for the initial three years of its operation. The relevant funding arrangement had been approved by LegCo before the establishment of FDRC. As regards the funding arrangement after the initial three years, the Administration would conduct review with the relevant parties when appropriate.

Market supervision

83. Mr Christopher CHEUNG considered that SFC should balance the interests of SMEs and large securities firms when formulating regulatory rules and guidelines for intermediaries. For instance, the requirements concerning liquid capital deficiency under the Securities and Futures (Financial

Resources) Rules ("FRR") warranted a review as it failed to give due regard to the business viability of SMEs. He pointed out that the reported net loss of Category C brokers had reflected the difficult operating environment for SMEs. Mr CHEUNG said that SFC should adopt a positive attitude towards SMEs, bearing in mind that the relatively smaller amount of assets and capital held by SMEs should not necessarily give rise to higher risks in their operation and compliance. He doubted whether FRR was fair for all firms irrespective of size, and suggested that SFC should review FRR for SME brokers. CEO/SFC said that it was SFC's principle to exercise fairness in regulation that would be conducive to creating a level playing field for all intermediaries. As regards the suggested review of FRR, CEO/SFC said that SFC was in the process of merging two of its departments, i.e. the Intermediaries Supervision Department and the Licensing Department, and the Executive Director of the merged unit would be in charge of a comprehensive review of the regulatory requirements for intermediaries, including FRR.

Office premises

84. Mr CHAN Kin-por considered that SFC should continuously review its financial position and re-consider the plan to acquire permanent office premises of its own so as to reduce the pressure of rental increase and avoid incurring renovation cost for rented office premises. The Chairman said that she did not object to the suggestion for SFC to purchase office property in future as long as it was for SFC's own use and not for making investment. C/SFC responded that SFC would review its financial situation and reserves annually, and re-visit the issue of acquiring its own office property before expiry of the five-year lease of the CKC office. He assured members that SFC did not intend to acquire office property for investment purpose.

Regulation of and licensing regime for corporate finance advisers

85. The Chairman advised that, as decided at the Panel meeting held on 7 January 2013, issues raised by Mr Kenneth LEUNG and Mrs Regina IP, namely, the regulation of financial advisers in carrying out regulated activities and the impact of the acquisition of the London Metal Exchange Holdings Limited ("LMEHL") by HKEx on the Hong Kong Mercantile Exchange, would be discussed under this agenda item. For members' reference, she said that SFC had provided written responses to the said issues (LC Paper Nos. CB(1)518/12-13(01) and (02)) before the meeting.

86. Mr Kenneth LEUNG noted from SFC's written response (LC Paper No. CB(1)518/12-13(01)) that the provision of advice on matters falling within the ambit of the Codes of Takeovers and Mergers and Share Repurchases, or on any offer to dispose of securities to or acquire securities from the public, or on listed corporations concerning corporate restructuring in respect of securities,

was required to hold a licence for Type 6 regulated activity (advising on corporate finance). He enquired whether "corporate finance advisory" and "financial advisory" were distinct categories subject to different regulation by SFC. CEO/SFC said that the regulatory approach was to ascertain whether a regulated activity was involved in first place, and if so, whether the intermediary in question was licensed or otherwise for carrying out that particular type of regulated activity. SFC made no distinction between "corporate finance advisory" and "financial advisory" in this regard. He referred members to the Annex to the SFC's written response for the prosecutions initiated by SFC from January 2010 to January 2013 in relation to unlicensed activities.

87. Mr Kenneth LEUNG said that HKEx announced the placing of new shares in November 2012 to fund the acquisition of the share capital of LMEHL, and the appointment of the China Development Bank Securities Company, Limited as financial adviser for the placement. Given the public concern about the issues arising from the appointment in relation to the regulation and licensing of financial advisers, he enquired whether SFC was investigating or looking into the matter. CEO/SFC said that he could not comment on any individual case under SFC's investigation, nor could he confirm whether SFC was making an investigation on a particular case as SFC had to observe the principles of fairness and due process. However, in view of the publicity over the case in question, he confirmed that SFC had been looking into the matter.

Motion

88. The Chairman read out the motion moved by Mr James TO and seconded by Mr Christopher CHEUNG:

> "本會要求證券及期貨事務監察委員會減低徵費。"
>
> (Translation)
>
> "That this Panel demands the Securities and Futures Commission to lower its levies."

89. The Chairman considered the motion directly relevant to the item under discussion. Members agreed to proceed dealing with the motion. The Chairman put Mr James TO's motion to vote. Of the members present, four members voted for the motion and no members voted against the motion. The Chairman declared the motion moved by Mr TO was carried.

VIII Any other business

90. There being no other business, the meeting ended at 12:40 pm.

Council Business Division 1
Legislative Council Secretariat
30 April 2013