

**立法會**  
**Legislative Council**

LC Paper No. CB(1)1131/12-13

(These minutes have been seen  
by the Administration)

Ref : CB1/PL/FA/1

**Panel on Financial Affairs**

**Minutes of meeting**

**held on Monday, 4 March 2013 at 10:45 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 WONG Ting-kwong, SBS, JP  
Hon Kenneth LEUNG  
Hon Dennis KWOK  
Hon SIN Chung-kai, SBS, JP

**Members attending :** Hon KWOK Wai-keung  
Hon TANG Ka-piu

**Members absent :** Hon CHAN Kam-lam, SBS, JP  
Hon Jeffrey LAM Kin-fung, GBS, JP  
Hon Andrew LEUNG Kwan-yuen, GBS, JP  
Hon Ronny TONG Ka-wah, SC  
Hon Mrs Regina IP LAU Suk-ye, GBS, JP  
Hon James TIEN Pei-chun, GBS, JP  
Hon NG Leung-sing, SBS, JP  
Hon Christopher CHEUNG Wah-fung, JP

**Public officers  
attending**

: Agenda Item IV

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

Miss Ada CHAN  
Principal Assistant Secretary for Financial Services  
and the Treasury (Financial Services) 2

Mr Edmond LAU, JP  
Executive Director, Monetary Management  
Hong Kong Monetary Authority

Mr Daryl HO  
Head, Market Development  
Hong Kong Monetary Authority

Agenda Item V

Miss Emmy WONG  
Principal Assistant Secretary for Financial Services  
and the Treasury (Financial Services) 3

**Attendance by  
invitation**

: Agenda item IV

Securities and Futures Commission

Mr Keith LUI  
Executive Director, Supervision of Markets

Mr Rico LEUNG  
Senior Director, Supervision of Markets

Ms Daphne DOO  
Director, Supervision of Markets

Agenda item V

Mandatory Provident Fund Schemes Authority

Mr Darren McSHANE  
Executive Director (Regulation and Policy)

Ms Gabriella YEE  
Head (Policy Development and Research)

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

**Staff in attendance :** Miss Winnie LO  
Assistant Legal Adviser 7

Ms Angel SHEK  
Senior Council Secretary (1)4

Ms Sharon CHAN  
Legislative Assistant (1)4

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Action

**I Confirmation of minutes of meetings and matters arising**

(LC Paper No. CB(1)585/12-13 — Minutes of the meeting on  
3 December 2012)

The minutes of the meeting held on 3 December 2012 were confirmed.

**II Information papers issued since the last meeting**

(LC Paper No. CB(1)537/12-13(01) — Letter dated 5 February 2013  
from the Administration in  
response to the issues raised  
by the Hong Kong  
Journalists Association in  
relation to the Companies  
(Residential Addresses and  
Identification Numbers)  
Regulation to be made under  
the new Companies  
Ordinance

LC Paper No. CB(1)558/12-13(01) — Administration's paper on  
fourth quarterly report of  
2012 on Employees  
Compensation Insurance —  
Reinsurance Coverage for  
Terrorism

LC Paper No. CB(1)620/12-13 — The Quarterly Report of the Securities and Futures Commission (October to December 2012))

2. Members noted the information papers issued since the last regular meeting held on 4 February 2013.

### **III Date of next meeting and items for discussion**

(LC Paper No. CB(1)599/12-13(01) — List of outstanding items for discussion

LC Paper No. CB(1)599/12-13(02) — List of follow-up actions)

3. Members agreed to discuss the following items proposed by the Administration at the regular meeting of the Panel on Financial Affairs ("FA Panel") in April 2013:

- (a) Relocation of the printing workshop of Government Logistics Department;
- (b) Extension of a supernumerary Administrative Officer Staff Grade C Post for the establishment of an independent Insurance Authority and a Policyholders' Protection Fund; and
- (c) Review of statutory fees and charges of the Official Receiver's Office.

4. Mr CHAN Kin-por noted that the regular meeting of the FA Panel was scheduled for Friday, 5 April 2013 which would clash with an overseas duty visit to be undertaken by the Panel on Environmental Affairs to the Republic of Korea from 1 to 5 April 2013. As some members of the FA Panel would join the duty visit, Mr CHAN suggested re-scheduling the next regular meeting to avoid clashing with the visit. The Chairman noted that enrollment for the duty visit was still in process. She invited the Secretariat to explore alternative time slots for re-scheduling the FA Panel meeting to avoid clashing with the duty visit as far as possible.

*(Post-meeting note: With the concurrence of the Chairman, the regular meeting in April 2013 was re-scheduled for Monday, 8 April 2013, at 9:00 am. Members were informed accordingly vide LC Paper No. CB(1)677/12-13 issued on 7 March 2013.)*

#### **IV Legislative proposal on the regulation of over-the-counter derivatives market**

(LC Paper No. CB(1)599/12-13(03) — Administration's paper on "Legislative Proposal on the Regulation of Over-the-counter Derivative Market"

LC Paper No. CB(1)599/12-13(04) — Updated background brief on regulation of over-the-counter derivatives market prepared by the Legislative Council Secretariat)

#### Briefing by the Administration

5. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Financial Services)<sup>1</sup> ("DS(FS)1") said that the Administration had briefed members at Panel meetings in 2011 and 2012 on the international developments in the regulation of the over-the-counter ("OTC") derivative market and the Administration's plan to introduce a regulatory regime for the OTC derivative market in Hong Kong. The Administration would like to consult members on related legislative proposal before finalizing the amendment bill for introduction into the Legislative Council ("LegCo").

6. With the aid of a powerpoint presentation, the Head, Market Development, Hong Kong Monetary Authority ("H(MD)/HKMA") briefed members on the background of international reform and regulatory developments for the OTC derivative market in Hong Kong. He said that under the current proposal, the broad framework for the regulation of OTC derivative market in Hong Kong would be set out in the Securities and Futures Ordinance (Cap. 571) ("SFO"), while the details would be stipulated in rules (i.e. subsidiary legislation) to be made by the Securities and Futures Commission ("SFC") with the consent of HKMA. H(MD)/HKMA then brought members through the key features of the proposed regulatory regime covering the mandatory requirements, product coverage, regulation of intermediaries, oversight of systematically important participants ("SIPs"), capital and margin requirements, as well as proposed mandatory reporting obligation of authorized institutions ("AIs"), approved money brokers ("AMBs"), licensed corporations ("LCs") and other prescribed persons.

7. The Senior Director, Supervision of Markets, SFC ("SD/SFC") briefed members on the proposed mandatory clearing obligation, including the clearing threshold, designated central counterparty ("CCP") and clearing channels. He said that two new regulated activities ("RAs") in relation to OTC derivatives would be introduced under Schedule 5 to the SFO, namely a new Type 11 RA to cover the activities of dealers and advisers and a new Type 12 RA to cover the activities of clearing agents. Furthermore, Type 7 RA (i.e. providing automated trading services) and Type 9 RA (i.e. asset management) would be expanded to cover OTC derivative transactions and management of portfolios of OTC derivative transactions respectively. SD/SFC further briefed members on the proposed transitional arrangements for market participants who were already engaged in activities to be covered by the proposed new RAs and expanded RAs, the proposals on oversight of SIPs, as well as the development of local infrastructure for the regulation of OTC derivative transactions. SD/SFC said that the Administration aimed to introduce into LegCo an amendment bill in the second quarter of 2013 to establish the regulatory framework for OTC derivatives, and conduct public consultation on the draft subsidiary legislation in the summer of 2013.

*(Post-meeting note: The notes of the powerpoint presentation (LC Paper No. CB(1)662/12-13(01)) were issued to members vide Lotus Notes e-mail on 4 March 2013.)*

## Discussion

### *Coverage of the proposed regulatory regime*

8. Mr Kenneth LEUNG noted that mandatory reporting and clearing of OTC derivative transactions would initially be applied to interest rate swaps ("IRSs") and non-deliverable forwards ("NDFs"). He enquired if NDFs would include cash-settled contracts for differences. The Executive Director, Monetary Management, HKMA ("ED(MM)/HKMA") said that NDF transactions were usually cash-settled in the US dollar, in particular NDFs denominated in Renminbi ("RMB") or other currencies that had lower liquidity or were subject to foreign exchange control.

9. Mr SIN Chung-kai and the Chairman sought information on the transaction volume and value of IRSs and NDFs in the Hong Kong market. Mr SIN further enquired whether the proposed product coverage would align with that of the Group of Twenty Commitments for the regulation of OTC derivative market. The Chairman considered that the volume of OTC derivative transactions to be subject to mandatory reporting and clearing would be small if the requirements would apply only to IRSs and NDFs in the initial phase of regulation. She enquired about the situation of retail investors engaging in

OTC derivatives transactions in the Hong Kong market vis-à-vis that of institutional or professional investors.

10. ED(MM)/HKMA advised that as currently there was no mandatory reporting requirement on OTC derivative transactions, market players were not obliged to report their OTC derivative positions. Nevertheless, based on the findings of a survey conducted some three years ago, the notional value of OTC derivative transactions in Hong Kong had reached some US\$16,000 billion, of which 18% and 17% were IRSs and NDFs respectively, whereas foreign exchange derivatives constituted the largest share, i.e. 58%. Credit derivatives (2%) and equity derivatives (5%) accounted for the remaining transactions. In terms of investor segments, 70% of the OTC derivative transactions were undertaken by AIs involving mainly institutional and professional investors, and 30% were end-users. The involvement by retail investors was small.

11. ED(MM)/HKMA said while it was the objective of the Group of Twenty Leaders to require mandatory clearing for all standardized OTC derivative trades through CCPs and mandatory reporting of all OTC derivative trades to trade repositories, the specific types of OTC derivative transactions to be included in the mandatory regulatory regime would be adjusted to cater for the unique circumstances and needs of respective jurisdictions. For instance, the United States of America and European economies would likely put priority in regulating OTC credit default swap transactions which were more common in their markets and associated with greater risks, whereas IRSs and NDFs accounted for more of the OTC derivative transactions in the Asian markets. Although foreign exchange derivatives constituted the greatest share of OTC derivative transactions in the Hong Kong market, the majority of them involved short-term foreign exchange swaps whose risk was relatively low. Besides, there was no consensus among major jurisdictions towards subjecting short-dated foreign exchange derivatives to stringent regulation. Depending on the development in the international arena, Hong Kong might consider regulating OTC equity derivatives and some of the OTC long-term foreign exchange derivatives at a later stage.

12. Mr Kenneth LEUNG expressed concern about the potential compliance burden arising from mandatory reporting and clearing of IRS transactions conducted between two companies only that did not involve banks or financial institutions which would be obliged to report such transactions under the proposed regime. ED(MM)/HKMA said that it had been observed that the counterparties for non-financial institutions in OTC derivative transactions in Hong Kong or overseas were mainly banks or financial institutions, and very few of such transactions were conducted between non-financial institutions. To minimize reporting burden, non-financial institutions would have to report reportable transactions to which they were counterparties only if their positions

exceeded the reporting threshold. If non-financial institutions' transactions involved an AI, LC or AMB, they would be exempted from the reporting obligation. Similarly, non-financial institutions that were counterparties to a clearing eligible transaction would be required to clear such transaction through a designated CCP if both the non-financial institutions and their counterparties had exceeded the clearing threshold.

13. Mr James TO expressed concern that if the reporting threshold was set too low, some investors might be caught by the law inadvertently. The Executive Director, Supervision of Markets, SFC ("ED/SFC") said that in working out the reporting threshold, factors, including the significance of the products' volume of transactions on the market, would be taken into account, and there would be consultation with the relevant stakeholders during the process.

*Definition of "Hong Kong nexus" in relation to reporting obligation*

14. Mr James TO noted that AIs, LCs and AMBs would be subject to mandatory reporting requirements if they were counterparties to the derivative transactions and the transactions have a "Hong Kong nexus". In the case of equity derivatives and credit derivatives, "Hong Kong nexus" would mean that the underlying entity or reference entity was listed in Hong Kong, and if there was more than one underlying entity or reference entity, a specified percentage of the entities were listed in Hong Kong. He enquired how the "specified percentage" would be set. H(MD)/HKMA said that the specified percentage was based on the notional value of the underlying entities or reference entities that were listed in Hong Kong as set out in the contract of the reportable OTC derivative transaction. For instance, a credit derivative might not be regarded as having a Hong Kong nexus if the majority of its reference entities were listed in Hong Kong but the sum of their notional value was less than the notional value of its unlisted reference entities.

15. Mr James TO enquired whether an entity not listed in Hong Kong but holding a number of Hong Kong-listed subsidiaries or a substantial value of Hong Kong assets would be caught in the definition of "Hong Kong nexus", and hence be subject to the mandatory reporting requirement. H(MD)/HKMA replied in the negative and pointed out that the purpose of regulating OTC derivative transactions was to allow the regulators to assess OTC derivative positions held by market players so as to monitor the build-up of exposures that might threaten the financial market or the wider economy. As reference entities that were not listed in Hong Kong would have relatively less impact on the local equity market or the wider economy than the listed entities, they would not be a concern in the risk assessment of OTC derivative transactions. SD/SFC added that an OTC derivative transaction with reference entities listed

outside Hong Kong would be subject to similar reporting requirements in the jurisdictions concerned. SFC would communicate with overseas regulators in monitoring the risk exposures of OTC derivative transactions on a global basis.

16. In reply to Mr James TO's enquiry, H(MD)/HKMA advised that, if a derivative contract was settled in the Hong Kong dollar or RMB but the underlying asset, currency or rate of the contract was not denominated in or related to Hong Kong dollar or RMB, the transaction would not be regarded as having a Hong Kong nexus, and hence would not be subject to the mandatory reporting requirement.

#### *Investor protection*

17. Mr Albert HO considered that although the mandatory reporting and clearing requirements would facilitate the regulators in assessing OTC derivative positions held by market players in maintaining banking and financial stability, the proposed regulatory framework was not conducive to enhancing investor protection, in particular for retail and small investors. Referring to the Lehman Brothers incident, Mr HO expressed concern that high-risk investment products, including derivatives, were mis-sold to investors due to inadequate supervision of banks and financial institutions.

18. DS(FS)1 advised that at present, the absence of a regulatory regime for OTC derivative transactions and the bilateral nature of such transactions had rendered it difficult for regulators to assess OTC derivative positions held by market players. The proposed regulatory regime would help monitor the build-up of exposures that might threaten the market or the wider economy, thus helping to strengthen the stability and resilience of the financial system, and reduce the potential of contagion risks affecting general investors arising from the global nature of the OTC derivative transactions and interconnectedness of market players. The proposed regulatory regime would also enhance investor protection in the area of licensing of intermediaries relating to OTC derivative transactions.

19. ED/SFC said that under the existing regulatory regime, documentation of derivative products that were offered on a "one-to-many" basis (as opposed to transactions that were negotiated and entered into on a bilateral basis) required SFC's authorization, and the offering was subject to suitability assessment and conduct regulation at the point of sale. The proposed introduction of new RAs relating to OTC derivative transactions and expansion of certain existing RAs to cover OTC derivative portfolios and transactions would accord better investor protection to both retail and institutional investors of OTC derivatives. ED/SFC added that the initial scope of mandatory reporting and clearing obligations would apply only to certain types of IRS and

NDFs because they were the major types of OTC derivative transactions, after foreign exchange derivatives, executed in Hong Kong. Equity derivatives were not included in the initial stage as such transactions lacked standardization in the documentation to facilitate mandatory reporting/clearing. Nevertheless, SFC would closely monitor the development in regulatory regimes for OTC derivative transactions in the international arena in considering expansion in the product coverage for mandatory reporting and clearing.

### Conclusion

20. The Chairman concluded that members had no objection to the Administration introducing the relevant bill into LegCo in the second quarter of 2013. She said that relevant issues raised by members at this meeting would be pursued by the bills committee if one was to be formed for scrutiny of the bill.

### **V Relevant income level for the purpose of mandatory contribution under the Mandatory Provident Fund Schemes Ordinance**

(LC Paper No. CB(1)599/12-13(05) — Administration's paper on "Relevant Income Levels for the Purpose of Mandatory Contributions under the Mandatory Provident Fund Schemes Ordinance"

LC Paper No. IN09/12-13 — Information note on "Minimum and maximum levels of relevant income for Mandatory Provident Fund contributions" prepared by the Legislative Council Secretariat)

*(The Chairman left the meeting at this juncture, and Mr CHAN Kin-por, the Deputy Chairman, took over the chair.)*

Briefing by the Administration

21. At the invitation of the Deputy Chairman, the Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)<sup>3</sup> ("PAS(FS)3") said that, given that the Statutory Minimum Wage ("SMW") would be raised to \$30 with effect from 1 May 2013, the Mandatory Provident Fund Schemes Authority ("MPFA") had conducted an interim review of the minimum level of relevant income ("Min RI") and the maximum level of relevant income ("Max RI") for Mandatory Provident Fund ("MPF") contributions. The Administration would like to seek members' views on the review findings and related legislative amendments proposed by MPFA before deciding on the legislative proposal.

22. With the aid of a powerpoint presentation, the Executive Director (Regulation and Policy), MPFA ("ED/MPFA") briefed members on the background of the interim review of Min RI and Max RI, the statutory adjustment mechanism, and findings of the last review in 2010. ED/MPFA then apprised members on the views of consulted stakeholders on the possible adjustments to Min RI and Max RI, and the key recommendations of MPFA as follows:

- (a) increasing the Min RI from \$6,500 to \$7,100 having regard to the new SMW of \$30 effective from 1 May 2013;
- (b) taking forward the second-phase adjustment of the Max RI last recommended by the MPFA in its 2010 review, i.e. increase the Max RI from \$25,000 to \$30,000; and
- (c) implementing adjustments to both the Min and Max RI simultaneously for administrative efficiency three months from the approval of the relevant subsidiary legislation by LegCo.

23. ED/MPFA said that MPFA also proposed to simplify the contribution calculation methods for casual employees of the construction and catering industries joining industry schemes to better cater for the needs of these employees and their employers, as set out in MPFA's review report (Appendix to LC Paper No. CB(1)599/12-13(05)).

*(Post-meeting note: The notes of the powerpoint presentation (LC Paper No. CB(1)662/12-13(02)) were issued to members vide Lotus Notes e-mail on 4 March 2013.)*

## Discussion

### *Impact of adjustments to Min RI and Max RI on MPF fees and charges*

24. Mr TANG Ka-piu said that the Hong Kong Federation of Trade Union would not oppose the proposed adjustments to Min RI and Max RI for MPF contributions as long as the proposal was agreeable to the Labour Advisory Board. Referring to the MPFA's consultancy study on trustees' administration costs released in November 2012, Mr TANG said that the weighted average fund expense ratio ("FER") of MPF was as much as 1.75%, and the findings of the consultancy study indicated that an increase in the scale of MPF assets would bring about benefits of economies of scale and help drive cost reductions. As such, he enquired whether the increase in total MPF contributions as a result of the proposed adjustments to Min RI and Max RI would bring about MPF fee reductions.

25. ED/MPFA said that an increase in the scale of MPF assets should in principle create room for reduction of administration costs on a per dollar basis. Nevertheless, how the reduction in costs would be reflected in fees would be a slightly different matter. He stressed that MPFA would continue to collaborate with the Government and the legislature in pursuing relevant measures to ensure any cost savings could be passed onto MPF scheme members in the form of lower fees and charges. ED/MPFA added that the weighted average FER was slightly lowered from 1.75% to 1.72% in February 2013.

### *Legislative timetable for implementing the proposed new Min RI and Max RI and the statutory adjustment mechanism for the two income levels*

26. Mr SIN Chung-kai enquired about the timetable for introducing the legislative amendments into LegCo to effect the adjustment to Min RI and Max RI. He asked if the timing of the future reviews of Min RI and Max RI would align with that of the SMW rate which was currently reviewed every two years.

27. PAS(FS)3 said that, subject to the views of Members, it was the Administration's target to introduce the relevant subsidiary legislation which was subject to the positive vetting procedures of LegCo in about May 2013. The new Min RI and Max RI were expected to implement three months from LegCo's approval, taking into account the time needed for publicity and for employers to make the necessary changes to their systems and procedures. As regards the statutory adjustment mechanism of Min RI and Max RI, the Administration noted that during the review exercise conducted in 2010, there were views that the adjustment mechanism should be reviewed having regard to the implementation of SMW, and MPFA was currently conducting a comprehensive review of the statutory adjustment mechanism. Subject to

progress of review and consultation, the new adjustment mechanism might be in place after 2014.

*Arrangement for offsetting severance payment or long service payment*

28. Mr KWOK Wai-keung expressed support for the proposed adjustment to Min RI and Max RI. Noting that with the proposed increase in Min RI from \$6,500 to \$7,100, an additional 53 300 employees and 8 400 self-employed persons whose monthly income was at or above \$6,500 but below \$7,100 would no longer be required to make the employee's mandatory contributions, he was concerned that the retirement protection for these scheme members would be undermined as the accrued MPF benefits for these scheme members would be reduced. The problem would be further aggravated as the accrued benefits attributable to employers' contributions could be used for offsetting the Severance Payment or Long Service Payment payable by employers ("SP/LSP offsetting arrangement"). Mr KWOK enquired about the Administration's plan in implementing the policy initiative in the Chief Executive's election manifesto to progressively reduce the proportion of accrued benefits attributable to employers' contributions that could be applied for SP/LSP offsetting arrangement. He urged the Administration to expedite action in this regard as abolition of the offsetting arrangement would facilitate implementation of full portability arrangement for the MPF Scheme in future.

29. PAS(FS)3 responded that the MPF system was only one of the three pillars of the retirement protection in Hong Kong that complemented voluntary private savings and the social security system. The issue of SP/LSP offsetting arrangement had been widely discussed before the MPF system was introduced, and there were still diverse views among different stakeholders on the matter. Before the community could reach a consensus on the offsetting arrangement, the Administration considered it practical to focus efforts on reducing MPF fees and charges at this stage.

Conclusion

30. Concluding the discussion, the Deputy Chairman said that members did not object to the Administration introducing the relevant legislative proposals into LegCo for implementing the proposals to adjust Min RI and Max RI and to simplify the contribution calculation methods for casual employees of industry schemes.

## VI Any other business

### Policy issues relating to regulation of collective investment scheme arising from the recent sale of hotel room units by the developer of The Apex Horizon in Kwai Chung

31. Mr Dennis KWOK referred to his letter addressed to the Chairman tabled at the meeting about the recent sale of hotel room units by the developer of The Apex Horizon in Kwai Chung, and the investment risks arising from hotel property investment schemes. Mr KWOK pointed out that, pursuant to section 103 of SFO, all collective investment schemes offered to the public were subject to SFC's regulation, and based on the wordings of the statutory definition, he opined that the investment scheme offered by the property developer of The Apex Horizon was within the definition of "collective investment scheme" and hence should be subject to SFC's regulation. He said that although the Panel on Development had discussed certain policy issues relating to the sale of hotel rooms of The Apex Horizon at its meeting held on 26 February 2013, the discussion did not involve the attendance of SFC and the regulatory implications for hotel property investment scheme under SFO as such matters fell within the terms of reference of FA Panel. Mr KWOK said that FA Panel should discuss related policy issues. He had written to SFC for a written response on the relevant issues.

32. The Deputy Chairman suggested and members agreed that the Panel would consider how to follow up the matter after SFC had provided the written response.

*(Post-meeting note: The letter dated 4 March 2013 from Hon Dennis KWOK to the Chairman on regulation of collective investment scheme (English version only) was circulated to members on 5 March 2013 vide LC Paper No. CB(1)664/12-13(01). The letter dated 4 March 2013 from Hon KWOK to SFC on the same matter (English version only) and SFC's written response dated 8 March 2013 (English version only) were circulated to members on 28 March 2013 vide LC Paper Nos. CB(1)791/12-13(01) and (02).)*

33. There being no other business, the meeting ended at 12:20 pm.