立法會
Legislative Council

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Panel on Financial Affairs

Minutes of meeting
held on Monday, 9 June 2014 at 2:30 pm
in Conference Room 1 of the Legislative Council Complex

Members present :	Hon Starry LEE Wai-king, JP (Chairman) Hon Christopher CHEUNG Wah-fung, JP (Deputy Chairman) Hon Albert HO Chun-yan Hon CHAN Kam-lam, SBS, JP Hon Abraham SHEK Lai-him, GBS, JP Hon WONG Kwok-hing, BBS, MH 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 CHAN Kin-por, BBS, JP Hon Mrs Regina IP LAU Suk-yee, GBS, JP Hon Kenneth LEUNG Hon Dennis KWOK Hon SIN Chung-kai, SBS, JP
Members attending :	Hon LEE Cheuk-yan Dr Hon LAM Tai-fai, SBS, JP Hon TANG Ka-piu Dr Hon CHIANG Lai-wan, JP
Members absent :	Hon James TO Kun-sun Hon James TIEN Pei-chun, GBS, JP Hon NG Leung-sing, SBS, JP

Public officers attending	**:**	Agenda Item IV Mr John TSANG, GBM, JP Financial Secretary Mrs Helen CHAN, JP Government Economist Mr Arthur AU Administrative Assistant to Financial Secretary Agenda Item V Prof K C CHAN, GBS, JP Secretary for Financial Services and the Treasury Ms Ada CHAN Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) 2
Attendance by invitation	**:**	Agenda item VI Mr Brian HO Executive Director, Corporate Finance Securities and Futures Commission Mr Bryan CHAN Co-head of Equities, Fixed Income and Currency Hong Kong Exchanges and Clearing Limited
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

I Confirmation of minutes of meetings and matters arising

(LC Paper No. CB(1)1406/13-14 — Minutes of the special meeting on 29 January 2014)

The minutes of the special meeting held on 29 January 2014 were confirmed.

II Information papers issued since the last meeting

(LC Paper No. CB(1)1452/13-14(01) — First Quarter Economic Report 2014 and the press release

LC Paper No. CB(1)1536/13-14(01) — Administration's paper on "Consultation Conclusions on Corporate Insolvency Law Improvement Exercise and Detailed proposals on a new Statutory Corporate Rescue Procedure")

2. Members noted the information papers issued since the last regular meeting held on 5 May 2014.

III Date of next meeting and items for discussion

(LC Paper No. CB(1)1543/13-14(01) — List of outstanding items for discussion

LC Paper No. CB(1)1543/13-14(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 7 July 2014:

(a) Consultation conclusions on corporate insolvency law improvement exercise and proposals on the introduction of a statutory corporate rescue procedure;

(b) Proposed amendment of the Banking (Capital) Rules and Banking (Disclosure) Rules and the making of a set of Banking (Liquidity) Rules for implementation of Basel III standards in Hong Kong;

(c) Briefing on legislative proposal to implement the stamp duty waiver in respect of exchange traded funds; and

(d) Consultation on Mandatory Provident Fund default/core fund proposal.

4. Members further agreed that the regular meeting on 7 July 2014 should start at 9:30 am to allow sufficient time for discussion of the above four items.

(*Post-meeting note*: At the request of the Administration and with the concurrence of the Chairman, an item on "Proposals to improve the regulatory regime for listed entity auditors" was added to the agenda of the meeting on 7 July 2014. To allow sufficient time for discussion, the meeting was advanced to start at 9:15 am and end at 1:00 pm. Members were informed accordingly vide LC Paper No. CB(1)1668/13-14 on 24 June 2014.)

IV Briefing by the Financial Secretary on Hong Kong's latest economic situation

(LC Paper No. CB(1)1452/13-14(01) — First Quarter Economic Report 2014 and the press release

LC Paper No. CB(1)1543/13-14(03) — Administration's paper on "Hong Kong's Recent Economic Situation and Near-term Outlook")

Briefing by the Administration

5. At the invitation of the Chairman, the Financial Secretary ("FS") briefed members on Hong Kong's latest overall economic situation.

(*Post-meeting note*: The press release containing the speaking note of FS (Chinese version only) was issued to members vide LC Paper No. CB(1)1589/13-14 on 11 June 2014.)

6. The Government Economist ("GE") gave a powerpoint presentation on the latest developments in the Hong Kong economy, covering areas such as external trade, domestic demand, the labour market, the local property market, inflation trends, as well as the economic outlook for the remaining of 2014.

(*Post-meeting note*: The notes of the powerpoint presentation (LC Paper No. CB(1)1587/13-14(01)) were issued to members vide Lotus Notes e-mail on 9 June 2014.)

Discussion

Macroeconomic conditions and interest rate movements

7. Given the uncertain pace of exit from monetary easing by the United States ("US") and introduction of negative interest rates by the European Central Bank recently to stimulate the Eurozone economy, Mr CHAN Kin-por sought FS' assessment about whether the low interest rate environment would persist in the near future.

8. Mr TANG Ka-piu considered that in view of the expected interest rate hike in the near to medium term, the Government should be vigilant of the rising level of household indebtedness and conduct related risk assessments for taking appropriate actions when necessary. He also suggested that the Government should assess risks arising from geopolitical instabilities, in particular the potential military conflicts between China and its neighbours (e.g. Japan, Vietnam and the Philippines).

9. Regarding US interest rate outlook, FS said that, notwithstanding the International Monetary Fund ("IMF")'s projection in April that the US economy would grow by 2.8% in 2014, its Gross Domestic Product ("GDP") only recorded a 2% year-on-year increase (or -1% quarter-on-quarter increase) in the first quarter of 2014. While the unemployment rate of the US fell to 6.3% in May 2014, the decline over the past year was partly helped by lower labour force participation rate, with the longer-term unemployment problem lingering on. Yet, consumer price inflation moved up to 2% in April 2014. If the US economy gained momentum down the road, it would be accompanied by the normalization of US monetary policy and the eventual interest rate hikes, even though the path to this end was subject to uncertainties. Nevertheless, the sound economic fundamentals and financial stability of Hong Kong should help withstand possible external shocks arising from future US monetary policy normalization. The situation in the eurozone was quite different, with growing concern about persistently low inflation in the region. The IMF forecast in April that the eurozone's GDP would grow only by 1.2%

in 2014. He assured members that the Government would keep a close watch on market developments.

Measures to stimulate the economy

10. Mr WONG Kwok-hing expressed concerns about the possible downward adjustment of the GDP growth forecast for 2014 in the next round of economic review, and decline in Hong Kong's competitiveness as reflected in the drop in its ranking from third in 2013 to fourth in 2014 in the World Competitiveness Yearbook published by the International Institute for Management Development. Domestically, there were concerns that the prospective "Occupy Central" movement might paralyze commercial activities in Central and nearby districts, and damage Hong Kong's reputation as an international financial centre. Meanwhile, the ongoing filibuster at the Finance Committee, Public Works Subcommittee and Establishment Subcommittee was delaying passage of a number of funding proposals for implementing budgetary measures to stimulate the economy. Mr WONG enquired how the Government would deal with the above situations to ensure early implementation of the measures.

11. FS said that, despite domestic demand holding steady, underpinned by public works and favourable labour market conditions that provided support to consumption, economic growth in the first quarter of 2014 was slower than that of the preceding quarter. Moreover, data at the start of the second quarter were also unsatisfactory. In particular, retail sales plunged by 9.5% in April 2014, the largest fall since February 2009, which partly reflected a decline in per-capita visitor spending. The Government would monitor the developments closely and stay vigilant. As regards the filibusters in various committees of the Legislative Council ("LegCo"), FS said that it was for LegCo to consider how to deal with such activities.

Retail sales and tourist spending

12. Mr CHAN Kin-por said that while there were community calls for reducing the number of visitors travelling under the Individual Visit Scheme ("IVS") and multiple-entry permit to minimize adverse impacts caused by the large number of visitors on the daily lives of local residents, the business sector was gravely concerned that adjustment in visitor arrivals would adversely affect the economy and labour market. Mr CHAN urged the Government to deal with related issues carefully with a view to minimizing economic loss to Hong Kong.

13. Mr CHAN Kam-lam cautioned that the Government should exercise prudence in handling issues such as the setting a quota for IVS, in view of the significant drop in retail sales in recent months, declining visitor consumption and possible negative impact on the local job market. In his view, the Government should tackle related problems by enhancing Hong Kong's capacity in receiving inbound tourists.

14. Mr WONG Ting-kwong pointed out that the recent discussion on proposal to reduce visitors under IVS by 20% had already led to volatilities in retail business-related shares in the stock market. While the surge in number of inbound visitors would inevitably cause inconvenience to the local people, he considered that the Government should take action much earlier to enhance Hong Kong's capacity to cater for the rapid growth in the number of Mainland tourists.

15. Dr CHIANG Lai-wan expressed concern about the overall economic situation, including weak external demand, slow growth in exports of travel services, and a lack of driving force for economic development in general. The retail business sector was gravely concerned about the sharp fall in retail sales in the first quarter of 2014 and possibility of further decline. Should retail sales contract further, it would deal a severe blow to the economy and the job market. While recognizing that inbound tourism was an important pillar of Hong Kong's economy, Dr CHIANG opined that the Government should not over-rely on the industry for supporting Hong Kong's economic development, and suggested that the Government should actively promote other economic sectors or industries in Hong Kong, e.g. develop Hong Kong brands and local products with competitive edges.

16. Dr LAM Tai-fai said that he was pessimistic about the outlook of Hong Kong's economic development in the coming few years due to uncertainties in the external environment arising from weakening external demand, slow economic recovery of the US and in Europe etc. He criticized the Government for adopting wrong measures to address problems, including the overheated property market and shortage in the supply of powdered formula, by suppressing the demand concerned which were contrary to the principles of a free trade economy. He was concerned that the Government would commit the same mistake by reducing the Mainland visitor numbers instead of drawing up effective measures to enhance Hong Kong's capacity in receiving inbound tourists and combat parallel trading activities. Dr LAM cautioned that any decision to reduce the visitor numbers under IVS and abolish the multiple entry permit system should not be taken lightly without first conducting thorough assessment on the possible impacts on the Hong Kong economy and the job market. He sought FS' view about whether the Government would

pursue the Chief Executive ("CE")'s suggestion of reducing the number of IVS visitors by 20%.

17. Mr LEE Cheuk-yan said that merely enhancing Hong Kong's tourist receiving capacity would not fully resolve related problems. He considered it necessary for the Administration to address community's concerns about excessive number of Mainland and the negative impacts on the livelihood of local people, such as congested traffic and over-crowdedness in MTR train compartments, rising property prices and rents, distortion in the retail market, etc. In this connection, he said that the Labour Party had suggested that the Government should stop issuing multiple-entry permits, in particular those not for family reunion purpose.

18. FS said that inbound tourism was an important pillar of the Hong Kong economy, generating economic benefits of around $80 billion in terms of value-added in 2012 or 3.9% of Hong Kong's GDP and offering nearly 220 000 employment directly or about 6% of total employment. Accordingly, should inbound tourism drop by 10%, holding other things constant, there would be a direct reduction of GDP by 0.39%, and a significant direct loss in number of jobs by 0.6%, but these two figures were crude estimates. The revenue from inbound tourism, measured by exports of travel services, after growing at a double-digit pace in real terms for four consecutive years, decelerated to 7.9% year-on-year in real terms in the first quarter of 2014. FS further clarified that the issue of reducing IVS visitors by 20% was mentioned by CE for seeking views of the Commission on Strategic Development, and was not a government proposal. The Government would maintain an open attitude to all feasible options in handling tourism-related issues, including examining measures to enhance Hong Kong's receiving capacity, with a view to fostering the stable and healthy development of the tourism industry and minimizing the adverse impacts on the daily lives of local people.

19. Mr SIN Chung-kai observed that the stance of the Government seemed to be inconsistent on how to tackle problems arising from the heavy visitor traffic, i.e. whether to reduce the number of IVS visitors by 20%, or increase the receiving capacity. He suggested that the Government should conduct studies on Hong Kong, Macau and other neighbouring regions to better understand the trends of inbound tourism, and identify the reasons for the drop in retail sales and per capita visitor spending in Hong Kong. The Chairman urged FS to exercise prudence in considering the way forward, including whether to impose a limit on the number of IVS visitors.

20. FS advised that the significant decline of 9.5% in the volume of retail sales recorded for April 2014 was mainly attributed to a drop in the sales of jewellery, watches and clocks, and valuable gifts. He said that the Government

would examine the reasons for the drop and the relevant economic data for the coming quarters to ascertain if the trend would continue. As the circumstances of Macau were different from those of Hong Kong, it would be inappropriate to make a direct comparison between the two cities in respect of their visitor arrival figures and spending patterns.

21. Mr WONG Ting-kwong enquired about the Government's short-term measures to enhance Hong Kong's capacity to receive tourists. The Chairman urged the Government to step up efforts to increase retail spaces, such as through building underground city and developing shopping centres at the border, and report the progress to the Panel at the next briefing.

22. FS said that the Government would conduct in-depth studies on the cost and other factors involved in enhancing Hong Kong's capacity to receive tourists. The relevant bureaux/departments and Hong Kong Tourism Board would continue to promote tourism and report relevant initiatives to LegCo. The Chairman and Mr WONG Ting-kwong urged the Government to expedite its studies and take timely actions to address the shortage of tourism facilities and enhance Hong Kong's tourist receiving capacity.

Household income and reducing child poverty risk

23. Mr Dennis KWOK expressed concern that the number of low-income households remained high despite continuous decline in the number of unemployed in low-income households and Comprehensive Social Security Assistance active caseload. In this connection, he noted that the Government would continue to invest substantially in education and training in order to improve competitiveness and skills of the workforce, increase social mobility, and reduce child poverty risk and inter-generational poverty. Mr KWOK enquired about the concrete measures taken/to be taken by the Government in these areas as he noted that the recurrent expenditure on education as a percentage of total recurrent expenditure had dropped in recent years.

24. FS said that recurrent expenditure on education had been rising in recent years although the percentage share in the total recurrent expenditure had decreased. All along, the Government reckoned the importance to enhance education, training and retraining services, and stayed vigilant of any upside risks to the unemployment situation. The Government would also endeavour to diversify the economy by providing continuous support to the pillar industries, tapping new markets and developing technology and innovative industries, so as to reinforce Hong Kong's position as an international financial centre and a regional logistics hub.

Labour shortage

25. Mr CHAN Kam-lam observed that the delays in some of the major infrastructure projects, including new railway lines, were partly attributable to acute labour shortage in the construction sector which also pushed up the construction costs. He suggested that the Government should consider importing labour to ensure adequate manpower supply for delivery of the projects in a timely manner.

26. FS said that it was the Government's principle to give priority to local workers in employment opportunities. Provided that the interests of local workers would not be adversely affected and a consensus could be reached between employers and employees, the Government would consider importation of labour where appropriate. He stressed that such measure was not meant to suppress wage growth but to give necessary impetus to economic development.

V Establishment of Shanghai-Hong Kong Stock Connect

(LC Paper No. CB(1)1543/13-14(04) — Administration's paper on "Establishment of Shanghai-Hong Kong Stock Connect")

Briefing by the Administration

27. At the invitation of the Chairman, the Secretary for Financial Services and the Treasury ("SFST") briefed members on the key features of the Shanghai-Hong Kong Stock Connect ("S-HK SC") and the progress of preparation for implementing the scheme.

(*Post-meeting note*: The speaking note of SFST (Chinese version only) was issued to members vide LC Paper No. CB(1)1589/13-14(02) on 11 June 2014.)

Discussion

Attendance of the Hong Kong Exchanges and Clearing Limited

28. Mr Christopher CHEUNG said that the financial services industry attached great attention to the implementation of the S-HK SC. Given the importance of the matter, he expressed disappointment that Mr Charles LI, Chief Executive of Hong Kong Exchanges and Clearing Limited ("HKEx"),

had not attended the current meeting to discuss related issues with Panel members. Mr CHEUNG added that, although Mr LI had taken forward a number of reforms/initiatives for HKEx or the Hong Kong stock market (such as introducing after-hours futures trading, shortening of lunch break under the extended trading hours, acquisition of the share capital of London Metal Exchange Holdings Limited ("LME"), and launching of the Orion Market Data Platform ("the Orion")) since he had taken up the present position, the trading volume of the securities market had not increased but declined. Furthermore, HKEx was caught in a number of lawsuits associated with LME. Mr CHEUNG also expressed concern that HKEx had failed to maintain effective communication with the securities industry. He urged Mr LI to review his work priorities with a view to improving the operation of the stock market and the business environment for the securities trade. The Co-head of Equities (Fixed Income and Currency), HKEx ("Co-head/HKEx") apologized on behalf of Mr Charles LI for being unable to attend the current meeting because he was out of town. He also said that over the past years, HKEx had been making its best efforts on the further development of the Hong Kong securities and futures markets. He would relay Mr CHEUNG's views to Mr LI after the meeting.

Benefits of the S-HK SC

29. Mr CHAN Kin-por opined that the S-HK SC would be conducive to the development of Hong Kong's economy at large. In taking forward the initiative, he considered that the Administration should take into account the operation of small and medium-sized enterprises ("SMEs") and strive to minimize negative impact on their business viability. The Chairman shared similar views. She enquired about the mechanism for SMEs to convey their views and suggestions to HKEx.

30. SFST said that, in considering each new initiative for the financial services sector, the Administration would take into account the development of Hong Kong's market as a whole rather than the interests of a particular sector of the industry. Notwithstanding this, the Administration recognized the need to assist SMEs in tapping new markets and would continue to provide appropriate facilitation measures where possible and necessary. As regards engagement with SMEs, SFST advised that the Administration and relevant regulators had been maintaining regular communication and meetings with representatives of SMEs and considered their suggestions and views from time to time.

31. Mr CHAN Kin-por enquired whether the Administration had assessed the quantifiable economic benefits of the S-HK SC for Hong Kong in respect of the various stakeholders e.g. HKEx, investors and securities firms. SFST

responded that it was envisaged that the S-HK SC would increase the turnover of the stock market and bring about positive impacts on different segments of the financial services sector, including asset management industry.

System requirements and security

32. Mr Christopher CHEUNG pointed out that the majority of securities firms had expressed concern about joining the S-HK SC due to cost considerations, including the capital cost for system set-up and upgrading their existing Orion to make it compatible with the S-HK SC system, and fees payable to HKEx. Mr CHEUNG suggested that HKEx should waive participating firms from payment of such costs and fees to encourage greater participation by the industry in the S-HK SC.

33. Co-head/HKEx explained that, due to time constraint, the S-HK SC system and its compatibility with the Orion had to be developed concurrently. The system and other technical aspects would be adjusted to enable application of the Orion to the S-HK SC system in future. Co-head/HKEx said that the fees for installing and operating the S-HK SC system (e.g. connection fees and telecommunication charges) were about $10,000 on average for each exchange participant. HKEx would consider means to address concern about costs raised by the securities industry and explore ways to enhance industry participation in the S-HK SC.

34. Mr Christopher CHEUNG expressed concern that the information service fee of $200 charged to exchange participants in Hong Kong for each terminal of HKEx's New Securities Trading Devices was much higher than that charged on the Mainland counterparts. Co-head/HKEx advised that HKEx currently provided data services to Mainland participants of the Stock Exchange of Hong Kong ("SEHK") under a promotion plan charging information service fee per terminal at $80 and $120 on retail and institutional investors respectively. The concessionary rates had taken into account the cross-boundary restrictions on the trading of Hong Kong-listed shares. HKEx would in future review the data services and fees as the market demand and structure changed.

35. Mr Christopher CHEUNG cautioned that due to the complex design of the S-HK SC system, for instance to insulate fund and securities flows in a closed loop of the two settlement systems, potential technical problems might arise. Referring to the earlier incident of system error in the after-hours futures trading system resulting in cancellation of affected transactions, Mr CHEUNG enquired about measures to mitigate risks on investors arising from similar system operational problems of the S-HK SC.

36. SFST said that the systems and technical requirements of the S-HK SC were not solely determined by the Hong Kong authorities as the S-HK SC involved the securities markets of both Shanghai and Hong Kong, and also issues pertaining to national security and further opening up of Mainland's capital market. It was understandable that the pilot scheme might encounter some "teething problems" in the initial phase and the relevant Mainland and Hong Kong authorities had been working together to address issues of concerns. Amongst other measures, the closed loop design of the settlement systems and imposition of quotas on the scheme were put in place to manage the risks arising from the system and enable smooth implementation of trading. Co-head/HKEx stressed that the S-HK SC system would undergo stringent testing prior to launch to ensure its reliability and security. The systems supporting the northbound trading (i.e. trading of eligible shares on the Shanghai Stock Exchange ("SSE") by Hong Kong investors) would also be segregated from the local stock market for prudent risk management.

37. In reply to the Chairman about the difficulties and issues which had yet to resolve in the run-up to the market rehearsal for the S-HK SC pilot scheme in September 2014, Co-head/HKEx said that SSE, SEHK, Hong Kong Securities and Clearing Company ("HKSCC") and China Securities Depository and Clearing Corporation ("ChinaClear") would liaise with market participants in relation to all rules, systems and technical requirements relevant to their operations. SEHK and HKSCC had conducted the first round of 14 briefing sessions for vendors in May 2014. The second and third rounds of briefings were scheduled for June/July 2014 and August 2014 respectively. As regards the technical readiness of the system, HKEx had conducted its internal testing and would conduct further testing with SSE and ChinaClear, followed by the market rehearsal in September 2014 with participation by the industry. In parallel, the Securities and Futures Commission ("SFC") and China Securities Regulatory Commission ("CSRC") were taking necessary measures to establish an effective regulatory and enforcement regime under the S-HK SC. HKEx was also working with SFC and the industry to put together an investor education programme.

Quotas

38. Mr CHAN Kam-lam welcomed the establishment of the S-HK SC in principle for enhancing the trading volumes on the stock markets of Hong Kong and Shanghai. He noted that buying of eligible shares listed on respective markets by investors would be capped at the aggregate net quotas of RMB250 billion and RMB300 billion, and daily net quotas of RMB10.5 billion and RMB13 billion respectively. He expressed concern that the prescribed daily quotas might restrict the trading orders in both markets, or result in quota wastage if the daily trading volumes were below the quotas.

Besides, the quotas would likely cause inconvenience to investors as they might not have information on the remaining daily net quota when placing their orders. Mr CHAN suggested that the daily net quotas should be reviewed after a trial period in the light of implementation of the S-HK SC pilot scheme.

39. SFST and Co-Head/HKEx pointed out that it was necessary to set quotas on cross-boundary trading in the initial phase in order to minimize market risks and avoid undue market volatility in the short term. Co-Head/HKEx explained that the aggregate and daily net quotas in question would apply on a net-buy basis, i.e. "netting" of buy and sell orders, which meant that the quotas should be able to support much larger trading volumes. SEHK would monitor the northbound daily net quota in "real time" such that once the quota balance dropped to zero or was reached, no further buy orders would be accepted for the remainder of the day. Subject to the aggregate quota balance, SEHK would resume the northbound buying service on the following trading day. The remaining balance of the daily net quota would be published at scheduled times on HKEx's website and datafeeds, which would be updated per minute or shorter intervals subject to further discussion. Co-Head/HKEx further explained that in the early stage of implementation, there would be more orders to buy than to sell eligible shares on both stock markets as the markets were building up the portfolio. However, the buy and sell orders should become more balanced over time and there would be less pressure arising from the daily net quotas after netting. As regards the aggregate quotas, they would be computed at the end of each trading day and likewise announced on the HKEx website but the aggregate quotas would not impact the daily trading volumes. The financial regulators of both sides would keep in view the operation of the quotas and make adjustment if necessary in the light of implementation and market demand.

Investor protection and cross-boundary enforcement

40. Mr CHAN Kam-lam considered that HKEx and SFC should work with the relevant Mainland authorities and regulators to ensure transparency of and access to SSE market information so as to enhance the confidence of Hong Kong investors in S-HK SC trading. He also asked about cross-boundary enforcement against market misconduct given concerns about differences in regulatory policies and practices of the Mainland and Hong Kong.

41. The Executive Director, Corporate Finance, SFC ("ED/SFC") said that SFC and CSRC would actively enhance cross-boundary regulatory and enforcement cooperation. Necessary measures would be put in place to establish an effective regime under the S-HK SC to respond to misconduct in either or both markets on a timely basis. Specifically, CSRC and SFC would improve the current bilateral agreement to strengthen enforcement cooperation

in respect of referral and information exchange mechanisms concerning improper activities; investigatory cooperation in relation to cross boundary illegal activities (including disclosure of false or misleading information, insider dealing and market manipulation); bilateral enforcement exchange and training; and enhancement of general standards of cross-boundary enforcement cooperation.

42. Mr Albert HO expressed concern that there might be regulatory gaps or loopholes in the regulation of cross-boundary trading under the S-HK SC, in particular in respect of high frequency trading ("HFT") activities. He noted that, during a recent media interview, Mr Anthony NEOH, Chief Adviser to CSRC, had raised concern about the capacity and experience of the Hong Kong regulators in dealing with different kinds of HFT activities which seldom appeared in the Hong Kong stock market.

43. SFST said that it was unlikely that market participants would conduct HFT activities in Hong Kong in view of the high costs associated with stamp duty payment and other fees charged in each transaction. ED/SFC pointed out that not all HFT activities involved market misconduct and it was necessary to look into each case having regard to the motives of the market participants concerned. ED/SFC further apprised members that SFC had introduced a regulatory framework for electronic trading since 1 January 2014, which covered internet trading, algorithmic trading and direct market access. Key aspects of the regulatory regime included (a) management and supervision (i.e. the responsibility to ensure compliance rested with the responsibility officers or executive officers and the management of the intermediaries); (b) adequacy of system (i.e. intermediaries should ensure their electronic trading systems were subject to testing and meeting regulatory standards with respect to reliability, controls, security and capacity and that contingency measures in place); (c) record keeping (i.e. intermediaries should keep, or cause to be kept, proper records on the design, development, deployment and operation of their electronic trading systems); and (d) risk management (i.e. intermediaries should put in place risk management and supervisory controls to monitor orders and trades, including automated pre-trade controls and regular post-trade monitoring). In addition, intermediaries should promptly report to SFC any material service interruption or other significant issues related to the electronic trading system they provided to clients for use. In reply to Mr Albert HO, ED/SFC said that the relevant codes of conduct for electronic trading were issued to the intermediaries for compliance and published on SFC's website. He undertook to provide supplementary information on the regulatory regime for electronic trading, including regulation against HFT activities.

(*Post-meeting note*: SFC's written response was circulated to members vide LC Paper No. CB(1)1707/13-14(02) on 27 June 2014.)

44. Mr Albert HO sought clarification about the application of laws of the Mainland and/or Hong Kong for compliance by investors of the two sides and cross-boundary enforcement by the relevant regulators. He considered that the regulators should step up education of investors of their obligations and about risks of trading stocks under the S-HK SC. ED/SFC said that listed companies would continue to be subject to the listing and other rules and regulations of the markets where they were listed. At the investor level, if a Hong Kong investor was involved in insider trading or other market misconduct in the trading of SSE securities, it would constitute an offence under the relevant rules of the Mainland. As regards whether the market misconduct in question would also constitute a breach of the regulations of Hong Kong, the relevant issues were under study by the authorities of the two sides. At the request of the Chairman, ED/SFC agreed to provide, when appropriate, information on enforcement cooperation against cross-boundary illegal activities (e.g. insider trading) and whether the laws of the Mainland and/or Hong Kong would prevail for compliance by investors of the two sides and in cross-boundary enforcement.

Admin

Legal services arising from the Shanghai-Hong Kong Stock Connect

45. Mr Dennis KWOK observed that implementation of the S-HK SC would create demand for related legal services from investors or other market participants of the Mainland in respect of the financial regulatory regime and rules of Hong Kong, and open up new opportunities for development of Hong Kong's legal services in the Shanghai Free Trade Zone in future. ED/SFC agreed that establishment of the S-HK SC would likely drive demand for the said legal services from Mainland investors. SFST observed that closer financial cooperation between Hong Kong and the Mainland would open up opportunities for development of professional services including legal services. The Administration would continue to explore business opportunities in the Mainland for the Hong Kong professional services sectors.

VI Any other business

46. There being no other business, the meeting ended at 4:30 pm.

Council Business Division 1
Legislative Council Secretariat
15 September 2014