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LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS

2014 Policy Address
Policy Initiatives of the Financial Services and the Treasury Bureau

INTRODUCTION

This information note outlines the key new and ongoing policy initiatives relating to the Financial Services and the Treasury Bureau ("FSTB").

FINANCIAL SERVICES

2. Benefiting from the gradual improvement in the world economy, global financial markets turned relatively stable in the past few months with selected stock market benchmark indices recording consecutive historical highs. Nevertheless, investors might expect an eventual normalisation of monetary environment amid the US Federal Reserve's announcement of the tapering of asset purchase, leading to a reversal of capital flows and return of market turbulence.

3. While the financial services sector in Hong Kong has demonstrated a high degree of resilience during the past few years notwithstanding the uncertain external environment, there is no room for complacency. Given the global financial markets may turn turbulent again, we together with market regulators will closely monitor the latest development of the global and local financial markets, and act swiftly as and when necessary to ensure the proper functioning of our financial markets.

4. Advanced economies and international regulatory organisations have meanwhile rolled out various financial reforms over the past few years in response to the systemic problems exposed by the 2008 financial crisis. Wide-ranging reforms, including that for regulating over-the-counter derivatives, introducing a resolution regime for financial institutions, implementation of the Basel III's capital, liquidity and disclosure requirements for banks, are either already being put in place or having formulated concrete timetable. As this series of reforms will have far-reaching implications on the financial services sector, we will, together with regulators, closely follow the latest development of the international financial reform and keep our regulatory framework up-to-date in a timely manner and at par with international standards. At the same time, we will participate proactively in the international deliberations on

standard settings to ensure that the reforms devised will be appropriate for the Hong Kong market.

5. Besides maintaining financial stability and enhancing the local regulatory regime, we strive to promote the sustainable development of Hong Kong's financial services sector and consolidate Hong Kong's position as an offshore renminbi ("RMB") business centre, international asset management hub and a leading global capital formation platform, so as to strengthen Hong Kong's economic competitiveness and provide a wide spectrum of employment opportunities to the labour market. We will further fortify financial cooperation with the Mainland, striving for greater market access for local financial services, while contributing to the reform and opening of the Mainland financial market in a mutually beneficial manner. We will also continue to collaborate with the industry in unleashing Hong Kong's strength in financial and professional services and encouraging development of new businesses to nurture a more diversified financial market in Hong Kong.

New Initiatives

(a) *Organisation of Asia-Pacific Economic Cooperation ("APEC") Finance Ministers' Meeting ("FMM") 2014*

6. We will maintain close liaison with the APEC Secretariat and the relevant ministries of the Central Government to ensure successful organisation of the APEC FMM in Hong Kong in September 2014. We will make use of this opportunity to showcase Hong Kong as China's global financial centre, explore economic cooperation opportunities with other economies in the region, and contribute to the chairmanship of the APEC 2014 by our country.

(b) *Auditor regulatory reform*

7. Auditors play the role as a key gatekeeper in assuring the integrity and accuracy of the financial reports of listed companies. Therefore, it is important that there is a robust regime for regulating the conduct of and upholding the professional standards of auditors of listed companies in order to uphold the integrity of Hong Kong's capital market and safeguard the interests of the investing public. In view of the international trend that the oversight of the regulation of auditors is to be independent of the profession itself, we are discussing with the Financial Reporting Council and the Hong Kong Institute of Certified Public Accountants ways to enhance the independence of our regulatory regime. A reform in this direction will align with international standards, enabling Hong Kong to meet the qualification requirements for

membership of the International Forum of Independent Audit Regulators and achieve recognition of regulatory equivalence by the European Union. This will enhance the quality of our capital market and international recognition of our auditors.

8. We plan to put forward a package of reform proposals for public consultation in mid 2014. Subject to the outcome of the consultation, we will prepare detailed legislative proposals with a view to introducing the necessary legislation into the Legislative Council ("LegCo") in the 2014-15 legislative session.

Ongoing Initiatives

Promoting Market Development

(a) Financial Service Development Council ("FSDC")

9. The Government established the Financial Services Development Council in January last year as a high-level cross-sectoral government advisory body to engage the industry and formulate proposals to promote the further development of Hong Kong's financial services industry and map out the strategic direction for development. The FSDC in November last year published its first batch of research reports, with a collection of concrete proposals on the development of offshore Renminbi business, asset management and real estate investment trusts. The Government and related regulators will study and follow up those recommendations. We hope the FSDC will further study and consult the industry on consolidation of our traditional competitive edges and the identification of new growth areas, particularly on topics such as Mainland opportunities, development of new businesses, promotion and human capital, and provide the Government valuable advice in these areas.

(b) Further advancing financial cooperation with the Mainland

10. We will seize the opportunities arising from the continual opening of the capital market in the Mainland, and make use of the supportive measures announced by the Central Government to fully develop offshore RMB business in Hong Kong, and continue to advance financial cooperation with the Mainland. Furthermore, by leveraging on the Mainland and Hong Kong Closer Economic Partnership Arrangement ("CEPA") and other regional cooperative platforms (such as those for Guangdong-Hong Kong, Shanghai-Hong Kong, and Shenzhen-Hong Kong (including Qianhai) cooperation), we will deepen our

exchanges and collaboration with the Mainland in respect of financial institutions, financial products, capital and talent for mutual benefits. With the decisions made at the Third Plenary Session of the 18th Central Committee recently to deepen economic and financial reforms, there will be more opportunities for cooperation between the two places. We will keep in view the developments and continue to maintain close communication with relevant Mainland authorities to capitalise on the opportunities arising from Mainland's continued economic and financial reform.

(c) *Offshore RMB business*

11. At present, Hong Kong has the world's largest offshore pool of RMB liquidity. As at the end of November last year, RMB deposits and outstanding RMB certificates of deposit altogether exceeded RMB1,000 billion, much higher than the total sum of that cumulated in the economies of Taiwan, Singapore and the UK.

12. As the world's largest offshore RMB business center, Hong Kong provides financial services such as RMB payment, financing and investment to enterprises around the world. The Renminbi Qualified Foreign Institutional Investors ("RQFII") scheme was expanded further in March last year, allowing financial institutions which are registered and have major operations in Hong Kong to apply for RQFII qualifications with relaxed investment restriction of RQFII funds, thereby enriching the types of RMB products. In addition, the CNH Hong Kong Interbank Offered Rate fixing, launched in June last year, provides a reliable benchmark for the market and serves as a reference for pricing of loan products. These developments have further enhanced and consolidated our position as the country's offshore RMB business center.

13. In order to further strengthen Hong Kong's offshore RMB business, we shall continue our dialogue with the relevant Mainland authorities to promote the development of offshore RMB business in Hong Kong, and deepen the circulation of RMB funds between the two places, complementing the country's target in realising the convertibility of the RMB capital account. With the world's financial centres starting to develop offshore RMB business, we are actively strengthening the RMB business links with overseas markets, promoting the RMB business between Hong Kong banks and international financial institutions and corporates, as well as providing RMB services to overseas financial institutions and corporates at the wholesale level.

(d) *Consolidating Hong Kong's position as the premier asset management centre in the Asia-Pacific region - introducing Open-ended Investment Companies and private equity funds taxation arrangement*

14. We are taking multi-pronged measures to foster Hong Kong as the premier asset management centre in the Asia-Pacific Region with comprehensive fund and asset management activities. We are working to provide a suitable legislative and regulatory framework, as well as a clear and competitive tax environment to attract different types of funds companies to base their operation in Hong Kong.

15. As there is a growing popularity among the fund industry to use open-ended investment companies as a vehicle for setting up investment funds, together with the Securities and Futures Commission ("SFC") and relevant government departments, we are formulating legislative proposals for the necessary regulatory framework to facilitate the introduction of these companies in Hong Kong. This new market choice will help attract more funds to use Hong Kong as their investment platform. We are at the final stage of preparing for the launch of a public consultation exercise in first quarter this year.

16. At the same time, to attract more private equity funds to domicile in Hong Kong, we are working on legislative amendments to extend the profits tax exemption for offshore funds. The proposed amendments aim to include transactions in private companies which are incorporated or registered outside Hong Kong and do not hold Hong Kong properties nor carry out business in Hong Kong, thus allowing private equity funds to enjoy the same tax exemption as offshore funds. We are now consulting the industry and hope to introduce the relevant legislative amendment into LegCo soon. We will continue to work with closely with SFC, relevant government departments and market stakeholders in taking forward the relevant studies and preparatory work.

(e) *Islamic bonds*

17. The Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance 2013, enacted by LegCo on 10 July last year, has enhanced the competitiveness of Hong Kong in the development of a sukuk market, as the legislation levels the playing field by providing a comparable taxation framework for sukuk vis-à-vis conventional bonds. To continue to make steady progress on this front, we see the merits of accommodating the issuance of sukuk under the Government Bond Programme

("GBP") in response to the prevailing market conditions and needs. We will introduce the Loans (Amendment) Bill 2014 into LegCo on 22 January 2014, which seeks to accommodate the issuance of sukuk under the GBP. This will help diversify the types of financial products and services available in our markets and consolidate our status as an international financial centre and asset management centre.

(f) *Developing the local bond market*

18. We will continue with our efforts to promote the development of the local bond market, including ongoing implementation of the GBP. We will engage market players to better meet evolving market needs.

(g) *Trust law reform*

19. The Amendment Ordinance reforming our trust law has commenced operation in December 2013, strengthening the competitiveness of Hong Kong's trust industry against other major common law jurisdictions and enhancing Hong Kong's status as an international asset management centre. The Government will continue to collaborate with the industry in promoting Hong Kong's edge in this area.

Enhancing Market Quality and Investor Confidence

(h) *Establishment of an independent Insurance Authority ("IIA")*

20. We propose to establish an IIA for the better protection of insurance policyholders, greater nimbleness in responding to regulatory challenges and more effective implementation of international standards. We are drafting the enabling bill and plan to submit it to LegCo in the first half of this year. In addition, the Bureau has set up a Working Group to discuss transitional issues related to the establishment of the IIA with the industry.

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

21. To better protect insurance policyholders' interest and maintain market stability in the event of insurer insolvency, we propose to establish a PPF as a safety net for policyholders. We have earlier announced the consultation conclusions and finalised proposals. We are currently discussing the implementation details with the industry to finalise the legislative proposals for an early introduction of the bill into LegCo.

(j) *Implementing the new Companies Ordinance ("CO")*

22. With the concerted effort of all the relevant parties over the past seven years, the work pertaining to the enactment of the new CO has been completed. The new CO can facilitate business, enhance corporate governance, ensure better regulation, and modernise the law, thereby strengthening Hong Kong's status as an international business and financial centre. We are well prepared to bring the new CO smoothly into operation on 3 March 2014.

(k) *Improving the corporate insolvency laws*

23. To consolidate Hong Kong's position as a major international business and financial centre, we have rolled out an exercise to improve the corporate insolvency laws to ensure that our corporate insolvency and winding-up regime can keep up with the latest developments and meet social and economic needs. The underlying objectives of the exercise are to facilitate more effective administration of the winding-up process and increase protection of creditors through streamlining and rationalising the company winding-up procedures and enhancing regulation of the winding-up process having regard to international experience. A public consultation on a package of legislative proposals was completed in July last year. Taking into account the consultation feedback, we are drafting the detailed legislative proposals. Our plan is to introduce an amendment bill into LegCo in the 2014-15 legislative session.

24. In parallel, we are also actively developing further the proposal to introduce a new statutory corporate rescue procedure for Hong Kong. Since the last public consultation on the introduction of a corporate rescue procedure and insolvent trading provisions, we have been studying various other key issues of the proposals. We plan to further consult stakeholders on the substantive proposals this year.

Implementing international standards, enhancing the regulatory regime

25. Hong Kong has continued to participate constructively in the relevant international financial fora, including the Basel Committee on Banking Supervision ("Basel Committee"), Financial Stability Board and International Organization of Securities Commissions, etc, in setting the agenda for financial reforms as well as contributing to drawing up implementing details. Hong Kong attends the Group of Twenty ("G20") Summits as part of China's delegation. We will continue with our active participation in these international fora and consider how best to refine our regulatory regime in the

light of developments in other international financial centres and specific environment of the local market.

(l) *<u>Regulatory regime for the over-the-counter ("OTC") derivative market</u>*

26. We are committed to establishing a regulatory framework for the OTC derivative market in Hong Kong. We introduced an Amendment Bill into LegCo in July last year. The Amendment Bill will enable Hong Kong to put in place an appropriate and effective regulatory regime which meets the requirements of the G20 and is in line with developments in other international financial centres. The key aspects of the proposed regime include introduction of mandatory reporting, clearing and trading obligations, regulation of the necessary infrastructure, and regulation and oversight of key players in the OTC derivative market in line with the G20 commitments as appropriate. In addition, the Hong Kong Monetary Authority ("HKMA") has established a trade repository, and implemented interim reporting requirements on banks since August last year. OTC Clearing Hong Kong Limited, established locally by the Hong Kong Exchanges and Clearing Limited, has also started to provide voluntary clearing services since November last year.

(m) *<u>Development of an effective cross-sectoral resolution regime for financial institutions</u>*

27. Following the global financial crisis in 2008, a number of international financial centres have pledged to pursue a series of regulatory reform initiatives under the G20 agenda to enhance the resilience and stability of the global financial system. One of such initiatives is the development of an effective resolution regime for financial institutions.

28. According to the Key Attributes of Effective Resolution Regimes for Financial Institutions ("Key Attributes") published by the Financial Stability Board in November 2011, the relevant authorities are vested with the resolution powers in resolving financial institutions in an orderly manner and without exposing taxpayers to the risk of loss from solvency support, while maintaining continuity of their vital economic functions.

29. In order to meet the standards, it will be necessary to vest in the relevant authorities the resolution powers set out in the Key Attributes in resolving financial institutions which are deemed systemically significant or critical if they fail. Currently, the financial regulatory authorities in Hong Kong have some but not all such powers. We have therefore launched the first

stage of public consultation on 7 January 2014, with a view to gathering views from the public and the financial services sectors in bridging the gaps which exist in our current resolution regimes for different types of financial institutions relative to the Key Attributes. We will carefully analyse the views gathered, and will launch the second stage of public consultation this year. Our target is to introduce the proposed legislation into LegCo in 2015.

(n) *Implementing new Basel requirements*

30. Hong Kong has implemented the first phase of Basel III capital requirements from 1 January last year in accordance with the Basel Committee's timetable. The new capital requirements have increased the level, quality and transparency of banks' capital base, as well as the risk coverage of the capital framework. HKMA is preparing other relevant Basel III rules under the Banking Ordinance according to the liquidity and capital buffer requirements promulgated by the Basel Committee. This will entail the making of the Banking (Liquidity) Rules, and amendments to the Banking (Disclosure) Rules and the Banking (Capital) Rules. The relevant subsidiary legislation will be introduced into LegCo within this year. In parallel, HKMA will continue to work closely with the banking industry and formulate relevant guidelines for Basel III implementation to facilitate compliance.

(o) *Countering money laundering and terrorist financing*

31. We will continue reinforce our efforts in implementing anti-money laundering measures, stepping up risk assessment and participating actively in the Financial Action Task Force.

Enhancing Financial Infrastructure

(p) *Enabling the introduction of an uncertificated securities regime*

32. Hong Kong currently has a paper-based securities market regime. Taking into account outcome of the earlier consultation, we propose to progress to an uncertificated securities regime in Hong Kong so that investors could choose to hold and transfer securities in uncertificated form thus possessing the legal ownership, instead of beneficial interest only, in the securities. This measure will help enhance the overall efficiency of our securities market, strengthen corporate governance, improve investor protection and maintain our market competitiveness. We are finalising an amendment bill to provide for the broad regulatory framework for enabling the introduction of an uncertificated securities market regime. We briefed the LegCo Panel on

Financial Affairs on the legislative proposals in January 2014 and plan to introduce the bill into LegCo in the second quarter of 2014.

(q) *Regulatory regime for electronic payment instruments and retail payment systems*

33. In view of the rapidly-advancing technologies and growing acceptance of innovative retail payment means, we are planning to amend the Clearing and Settlement Systems Ordinance to provide a comprehensive regulatory framework for stored value facilities and retail payment systems. This serves to offer better protection for clients, and enhance the safety and soundness of such facilities and services. FSTB and HKMA jointly consulted the public on the proposed regulatory framework in the middle of last year. The responses were generally positive and favourable. We are now analysing the views collected, and expect to introduce an amendment bill into LegCo this year.

(r) *Enhancing the Mandatory Provident Fund ("MPF") System*

34. As a retirement protection scheme, the MPF System, which has been implemented for 13 years, is still at its initial stage and requires further improvement. In this regard, we have been working together with the Mandatory Provident Fund Schemes Authority ("MPFA") to introduce a variety of measures to improve market transparency, promote market competition and enhance the arrangements of the System. Last year, we announced a series of measures to help reduce MPF fees. Some achievements have been made. For example, the management fee of 26% of MPF funds (or 124 funds) has been reduced last year, with the largest reduction being 44% or 80 basis points. In early 2014, each MPF scheme, except those which will be merged shortly, will have at least one low-fee fund, which invests in equities and/or bonds and with management fee not higher than 1.0% or fund expense ratio of 1.3% or below, for scheme members' selection.

35. We and MPFA will continue to enhance the various areas of the MPF System. Key initiatives of this year include –

(i) consulting the public on proposals regarding the introduction of a default/core fund. The proposed fund aims to improve the default arrangements in the MPF System, with a view to facilitating MPF scheme members to make investment choices in MPF funds. It would be designed with a long term investment perspective and an investment strategy which balances investment risk and return over the long term, by using for instance, mixed asset funds or life-cycle/target-date funds. Fees of the fund will be controlled and monitored. We aim to conduct the public consultation in the first half of 2014;

(ii) introducing legislative amendments into LegCo within 2013-14 legislative session, including those to simplify certain operational requirements by trustees so as to increase their scope for fee reduction and facilitate MPFA to perform its functions more effectively; and

(iii) conducting a study on the implementation of Full Portability by MPFA, which includes the cost and effectiveness of various proposals, with a view to further increasing employees' autonomy in selecting their MPF schemes. MPFA expects to submit its recommendations to the Government for consideration by end 2015.

THE TREASURY

Tax Information Exchange Arrangements

36. It remains our policy priority to seek to expand Hong Kong's network of comprehensive agreements for avoidance of double taxation ("CDTAs"), covering Hong Kong's major trading and investment partners as well as emerging economies with which we see potential for growth in bilateral trade and investment. By doing so, we could facilitate the flow of trade, investment and talent between Hong Kong and the rest of the world, as well as enhance Hong Kong's position as an international business and financial centre. Up to mid January 2014, Hong Kong has signed 29 CDTAs.

37. Meanwhile, we reckon the latest international standard on exchange of information ("EoI") for tax purposes that a jurisdiction should make available both CDTA and tax information exchange agreement ("TIEA") as instruments for EoI with other jurisdictions. With the enactment of the Inland Revenue (Amendment) (No. 2) Ordinance 2013 in July last year, Hong Kong is now able to enter into standalone TIEAs with other jurisdictions where necessary. While we will continue our utmost efforts to persuade our trading and investment partners to pursue CDTAs with Hong Kong, in view of the international standard that a jurisdiction cannot refuse to enter into an EoI agreement because of preference for CDTAs over TIEAs, we have started TIEA

negotiations with a number of jurisdictions (e.g. the United States and a few Nordic jurisdictions) which are not interested in pursuing CDTAs with Hong Kong.

38. With the growing aspirations of the international community on tax transparency and cooperation on an automatic and multilateral basis, the Government will review the EoI arrangements in Hong Kong in the light of experience gained under CDTAs and TIEAs. The Government will continue to engage local stakeholders and address relevant policy and legal issues, with a view to developing a sustainable model of EoI for Hong Kong.

Financial Services and the Treasury Bureau
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