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Report of the Panel on Financial Affairs
for submission to the Legislative Council

Purpose

This report gives an account of the work of the Panel on Financial Affairs ("the Panel") for the 2013-2014 legislative session. It will be tabled at the meeting of the Legislative Council ("LegCo") of 9 July 2014 in accordance with Rule 77(14) of the Rules of Procedure of LegCo.

The Panel

2. The Panel was formed by a resolution passed by LegCo on 8 July 1998 and as amended on 20 December 2000, 9 October 2002, 11 July 2007 and 2 July 2008 for the purpose of monitoring and examining government policies and issues of public concern relating to financial and finance matters. The terms of reference of the Panel are set out in **Appendix I**.

3. For the 2013-2014 session, the Panel comprised 18 members, with Hon Starry LEE Wai-king and Hon Christopher CHEUNG Wah-fung elected as Chairman and Deputy Chairman respectively. The membership list of the Panel is in **Appendix II**.

Major work

<u>Macro economy</u>

4. During the 2013-2014 session, the Panel continued to provide a forum for LegCo Members to exchange views with the Financial Secretary ("FS") on matters relating to Hong Kong's macro-economic situations. On the economic outlook for 2014, the Panel noted at the meeting on 9 June 2014 that for 2014 as a whole, the gross domestic product ("GDP") growth was forecast to be 3-4%,

while the forecast rates of headline and underlying consumer price inflation were 4.6% and 3.7% respectively. FS pointed out that uncertainties, including fluctuations in interest rate expectation and international capital fund flows with exit from the loose monetary policy in US, heightened geographical risks in some Asian and European economies, and decline in local retail sales in April 2014, if persisted, could dampen Hong Kong's economic performance and put pressure on the labour market.

Hong Kong's competitiveness

5. Members noted with concern about the decline in Hong Kong's overall competitiveness as reflected by findings of some international surveys and urged the Administration to step up measures to strengthen Hong Kong's competitiveness on various fronts, including promoting new economic sectors and supporting new industries, capitalizing on the development opportunities in the Mainland, and assisting the small and medium-sized enterprises ("SMEs") which are the major driving force of economic development and employers to about half of the local workforce.

6. FS stressed that Hong Kong's competitiveness stayed on par with major international financial centres. In strengthening Hong Kong's competitiveness, the Government would continue to diversify the economy, including exploring further growth opportunities and sharpening the competitiveness of the four pillar industries through developing Islamic finance and high value-added logistics services, and opening up opportunities for the local services industries to tap the Mainland market. In parallel, the Government would continue to support the development of new industries, enhance the domestic sector, maintain a favourable business environment and a sound legal system, as well as ensure fair competition with a view to attracting more foreign investment. Recognizing SMEs' contributions to the Hong Kong economy, the Government had always been mindful of their needs and would put forward appropriate measures under the 2014-2015 Budget to promote economic development and support enterprises.

7. In view of wide public concern about Hong Kong's capability in coping with the surge in number of Mainland tourists in recent years, some members opined that the Government should consider setting a limit on the number of tourists travelling under the Individual Visit Scheme and stop issuing multi-entry permits. On the other hand, some members noted with grave concern the notable year-on-year drop of 9.5% in retail sales recorded in April 2014 and the adverse impact on the economy. These members were worried that the adjustment in visitor arrivals would bring a severe blow to the overall economy and pose a negative impact to the employment situation. They stressed the need for the Government to consider related issues in a cautious and prudent manner, and conduct in-depth analysis on the impacts and trends.

8. FS responded that the Government recognized the contribution of inbound tourism in recent years to Hong Kong's economy but was also aware of the challenges it had brought. FS assured members that the Government would continue to enhance Hong Kong's capability in receiving inbound tourists, including upgrading tourist facilities and increasing tourist accommodation. It would also adopt a multi-pronged approach in addressing tourism-related issues and tackling the problems arising from the visitor arrivals with a view to striking a balance between the impact of the tourism industry on Hong Kong's economy and the livelihood of the community. On the other hand, the community was urged to make serious and rational discussions on related issues.

9. Noting that the labour market remained tight, some members urged that the Government should critically examine the need of importing labour in sectors which suffered from acute labour shortage problem. FS advised that the Government's principle was to give priority to local workers in employment opportunities, and the issue of importing labour to address labour shortage problem in some trades/sectors warranted thorough consideration in order to strike a proper balance between the interests of both employers and employees.

Property market

10. As regards development in the residential property market, while the Panel noted that the market continued to consolidate with implementation of the Government's demand-side management measures to cool down exuberance in the market, there was concern that the market had become stagnant. Some members cautioned that the measures could only suppress flat demand temporarily and the huge accumulated demand would push up flat prices further and cause more damage to the property market.

11. FS pointed out that notwithstanding decline in the overall flat prices by a cumulative 0.7% in April 2014 as compared with the peak in August in 2013, home purchase affordability of the general public as measured by the mortgage-to-income ratio stayed elevated at around 56% in the first quarter of 2014, which exceeded the long-term average of 47.3% over 1994-2013. Should interest rates rise by three percentage points to a more normal level, the ratio would soar to 73%. Whilst the Government's top policy was to enhance flat supply through increasing land supply in ensuring the healthy and stable development of the property market, given the uncertain interest rate environment, the risks of a property market bubble remained elevated. It was necessary for the Government to continue with the various counter-cyclical measures.

12. As for the suggestion that the Government should devise objective indicators for determining the timing to exit from the demand-side management measures, members noted that the Government would take into account a basket of factors, including the conditions in the external environment, interest rate movement, directions of fund flows, affordability of Hong Kong people, etc.

Monetary affairs

13. The Panel continued to receive regular briefings by the Chief Executive of the Hong Kong Monetary Authority ("HKMA") and his colleagues on the work of HKMA. At these briefings, HKMA provided information on the global, regional and local financial and economic situations, assessment of risk to Hong Kong's financial stability, development of Hong Kong's financial infrastructure, banking supervision, and performance of the Exchange Fund ("EF").

The Exchange Fund

14. The Panel noted that the investment income of EF for 2014 amounted to $81.2 billion, and the investment income for the first quarter of 2014 was $11.1 billion. The fixed rates for calculating the payment to the fiscal reserve placed with EF were 5% and 3.6% in 2013 and 2014 respectively.

15. Some members expressed concerns about the investment income of EF and the assets classes held, and enquired about measures taken by HKMA in diversifying EF's investment and controlling associated risks. On the forecast of EF's investment returns for 2014, the Panel noted HKMA's views that the possible interest rate hike would be unfavourable to return from bonds. Whereas returns from equities would be susceptible to changes in the global economic and investment environment. With the pace of US's exit from quantitative easing still uncertain, it would be difficult to make predictions on interest rate movements for adjusting EF's investment strategies. Members noted that HKMA had been exercising caution in diversifying EF's investment and attaching importance to risk management. The investment of the Long-term Growth Portfolio ("LTGP") of EF, which held new asset classes such as real estate and private equities, was capped at a level equivalent to one-third of the Accumulated Surplus of EF. LTGP was designed for investment in the medium and longer term in order to diversify EF's investment. Regarding risk management, the Panel noted that HKMA had put in place stringent guidelines for investment management and conduct of due diligence for individual investment items. The Investment Sub-Committee of the Exchange Fund Advisory Committee of HKMA monitored closely the investment management work of HKMA.

Credit growth and mortgage lending

16. The Panel noted with concern the substantial loan growth since early 2013 with loans for use outside Hong Kong, particularly Mainland-related lending, accounted for about 30% of the total loans approved by banks. Members called on HKMA to conduct analysis on the situation to better understand the risks, and put in place measures to manage possible credit and liquidity risks on the banking system and the economy.

17. HKMA advised that banks were required to follow measures and requirements set by HKMA in their daily operation for managing liquidity and credit risks. HKMA introduced the Stable Funding Requirement in late 2013 with the aim to providing further guidance to banks in ensuring a stable funding source necessary for them to maintain a sustainable credit flow and avoid liquidity risk in the event of massive capital outflow. Banks were also reminded of interest rate risks and their impact on asset prices and borrowers' repayment capacities. With the growth in Mainland-related lending, HKMA had strengthened the oversight of branches of Hong Kong-licensed banks in the Mainland, including stepping up on-site examinations to these banks and enhancing enforcement cooperation with relevant Mainland's financial regulators.

18. Members expressed concern about the low interest rate environment fuelling speculation in the property market. HKMA responded that the outlook of the property market and movement in prices remained uncertain although the market had cooled down with implementation of the demand-side management measures since February 2013. The Panel noted that HKMA had introduced six rounds of countercyclical prudential measures since October 2009 with the aim to maintaining banking stability against possible reversal of the low interest rate environment by strengthening banks' mortgage underwriting standards, constraining excessive mortgage lending and hence minimizing the potential interest rate shock on mortgage borrowers. HKMA would monitor the developments and adjust its countercyclical prudential measures in accordance with the property market cycles.

Development of Renminbi business in Hong Kong

19. With the rapid growth in Hong Kong's Renminbi ("RMB") business in recent years, financial development in Qianhai, and the imminent implementation of the Shanghai-Hong Kong Stock Connect ("S-HK SC"), members considered that it was an opportune time to abolish the RMB daily conversion limit and enquired about the progress of discussion with the Mainland's authorities in this area. HKMA responded that the Qianhai co-operation and S-HK SC would serve as channels for opening up cross-boundary RMB fund flows, and enhance the liquidity of the offshore

RMB market and create momentum for further development of the Hong Kong's capital markets. The financial services industry in general welcomed early abolition of the daily exchange/withdrawal limit of RMB 20,000, and HKMA had put forth the proposal to the Central People's Government and discussed the matter with People's Bank of China ("PBoC") on a number of occasions. There has been positive response from the Central Government on the matter, and the detailed proposal was under active consideration by PBoC.

Proposed regulatory regime for stored value facilities and retail payment systems in Hong Kong

20. The Panel welcomed the Administration's initiative to amend the Clearing and Settlement Systems Ordinance (Cap 584) ("CSSO") to provide for a new regulatory framework for stored value facilities ("SVF") and retail payment systems in Hong Kong, which would enhance customer protection and help maintain public confidence in payment systems. The Panel was briefed on the legislative proposal on 7 April 2014.

21. On the proposed licensing regime for SVF issuers, members noted that one of the licensing criteria required an issuer to establish physical presence in Hong Kong by setting up a locally incorporated company. Members were concerned about regulation of online international payment systems with operation across a number of jurisdictions but without physical presence in Hong Kong. HKMA advised that SVF issuers without physical presence in Hong Kong would not be licensed and would be prohibited from soliciting business in Hong Kong. If the unlicensed SVF issuer continued its online operations and targeting the members of the public in Hong Kong, the Administration and HKMA would notify the relevant regulator of the home jurisdiction of the unlicensed SVF issuer of its unlawful activities in Hong Kong. Members of the public in Hong Kong would also be informed that the issuer was unlicensed and the float (i.e. all money received from the users) given to the issuer might not be adequately protected.

22. As far as exemption for SVFs from the licensing regime was concerned, members noted that since single-purpose SVF was common in Hong Kong, e.g. prepaid coupons issued by cake shops, and taking into account comments received in a previous public consultation that the incorporation of single-purpose SVF into the licensing regime would cause inconvenience to the public, the Administration had proposed to exempt single-purpose SVFs. Moreover, consideration would be given to exempt certain multi-purpose SVFs (such as multi-purpose value cards used in local universities) which could only be used within, or within close proximity to the issuer's premises, or for the purchase of a limited range of goods or services from a limited number of shops or services providers. In granting exemption for SVF issuers, HKMA would take into account the prevailing market circumstances.

23. Members stressed the need to provide adequate protection for personal data kept by SVF issuers and suggested that the relevant legislative proposal should include explicit provisions in this regard. The Administration advised that licensed SVF issuers would not be allowed to use the personal data of its customers for other purposes without customers' prior consent. Moreover, they would be subject to safety and security requirements, including compliance with the data protection regulation in Hong Kong.

<u>Securities and futures market</u>

Shanghai-Hong Kong Stock Connect pilot programme

24. In April 2014, the China Securities Regulatory Commission ("CSRC") and the Securities and Futures Commission ("SFC") jointly announced the development of a pilot programme for the S-HK SC to establish mutual stock market access between Shanghai and Hong Kong which would allow investors of both places to trade eligible shares listed in the other market through local securities firms. The Panel discussed with the Administration, SFC and the Hong Kong Exchanges and Clearing Company Limited ("HKEx") on the subject at the meeting on 9 June 2014. The Panel welcomed the pilot programme in enhancing the opening up of the Mainland's capital markets and reinforcing and strengthening Hong Kong's position as a premier international financial centre and offshore RMB business centre. Members considered that both sides should work out the details, including the clearing and settlement arrangements and operation of the trading quota, as soon as possible and inform market participants and investors to enable them to make early preparation.

25. The Administration informed the Panel that HKEx and the Shanghai Stock Exchange had been working closely to develop details of the pilot programme. The Administration assured members that the pilot programme would be launched only after relevant trading and clearing rules and systems had been finalized, all regulatory approvals had been granted, market participants had had sufficient opportunity to configure and adapt their operational and technical systems, and the necessary investor education programmes had been in place. Members noted that HKEx and the Hong Kong Securities Clearing Company Limited ("HKSCC") had disseminated information on the pilot programme to their respective participants, and HKEx was working closely with the Investor Education Centre to put together an investor education programme for both institutional and retail investors on the pilot programme. Preparatory work for the pilot programme would take about six months and the two exchanges planned to conduct the market rehearsal in September 2014.

26. Some members expressed concern about cross-boundary regulatory issues and cooperation between the regulatory authorities in taking enforcement actions against illegal activities and misconduct in both markets. The Administration emphasized that CSRC and SFC would take all necessary measures to establish an effective regime under S-HK SC to respond to all misconduct in either or both markets on a timely basis. The two regulators would upgrade the current bilateral agreement to strengthen enforcement cooperation in respect of major areas including, referral and information exchange mechanisms concerning improper activities, and investigatory cooperation in relation to cross boundary illegal activities, etc. At the request of the Panel, SFC agreed to provide supplementary information regarding regulation against high-frequency trading and application of laws of the Mainland and/or Hong Kong in cross-boundary enforcement actions against illegal trading activities.

27. Given the cost implication on SME securities firms arising from capital investment in technical systems for joining the S-HK SC pilot programme, some members urged HKEx to consider waiving the relevant fees for SME securities firms in joining the pilot programme. HKEx responded that it attached importance to ensuring security and reliability of the technical systems for the pilot programme as well as promoting the programme to more SME securities firms, and would consider how best to address market participants' concern about the impact on costs.

Budget of the Securities and Futures Commission for the financial year of 2014-2015

28. The Panel discussed SFC's proposed budget for the 2014-2015 financial year at the meeting on 7 February 2014. Some members noted with concern the substantial increase in SFC's headcounts and the implication on tightening of supervision of intermediaries and implementation of enhanced regulatory initiatives by SFC, thus increasing compliance burden on the securities industry. They urged SFC to strike a proper balance between enhancing regulation and development of the financial services industry.

29. SFC explained that the proposed manpower increase was mainly to enhance efficiency of its enforcement process and regulation of listed companies, as well as to deal with the steady increase in licensing applications. Increased regulation over the securities market and intermediaries was in line with the development in the international financial markets in pursuing structural reforms to address problems exposed by the global financial crisis in 2008. SFC stressed that the same regulatory approach was adopted for all licensed corporations having regard to their potential risks to the market and irrespective of their sizes, and SFC would consult the industry before introducing new regulatory requirements. The Panel noted that recognizing

the pressure of the financial regulatory reform on the industry, SFC had proposed to extend the two-year annual fee waiver for licensees with effect from 1 April 2014 and set aside $20 million for funding training initiatives for intermediaries, particularly those in SMEs, to help them meet the challenges arising from a changing market landscape.

30. The Panel welcomed SFC's proposal to reduce the levy rate by 10% which would benefit the ordinary investors by lowering the investment cost and in turn would enhance the business opportunities for securities firms. Some members considered that SFC's projection of the average daily securities market turnover at $65 billion for 2014-2015 too conservative and there was room to reduce the levy rate further. SFC advised that for proper budgetary planning, it was appropriate and necessary for SFC to adopt a conservative projection of the market turnover and its income. Members noted SFC's undertaking to keep in view the actual market turnover in each year and its financial position in deciding adjustments of the levy rate as appropriate.

Introduction of an uncertificated securities regime

31. At the meeting on 6 January 2014, the Panel was briefed on the legislative proposal to provide an enabling environment for introducing an uncertificated securities market in Hong Kong. Whilst the Panel generally supported the initiative, some members expressed concern about the proposal of implementing the regime in phases with a dual system during the transitional period under which the existing paper-based system would continue to operate in parallel with the proposed uncertificated securities regime. Moreover, with the initial focus of the regime to cover shares of listed companies which were incorporated in Hong Kong, some members were concerned that the proposed regime could hardly achieve market efficiency and cost-effectiveness as some 70% of the listed companies in Hong Kong were incorporated in other jurisdictions. The Administration was urged to work out a concrete timetable for implementing a fully uncertificated securities market and expanding the regime to cover shares of non-Hong Kong incorporated companies.

32. The Administration explained that it would be appropriate to take forward the proposed regime in a progressive manner, and implementation of a fully uncertificated securities market regime would proceed taking into account among others, experience in operating the dual system, market readiness, and investors' adaptation to holding their shares in an uncertificated form. Moreover, as Hong Kong incorporated companies were governed by Hong Kong law, the Government would be in a better position to initiate necessary amendments to such laws to include these shares under the proposed regime. The regime would be expanded to cover shares of companies incorporated under other jurisdictions as and when the necessary approvals or laws of such jurisdictions were in place. The Administration/SFC would discuss with the

relevant authorities of other jurisdictions in parallel when proceeding with the current legislative exercise in Hong Kong with the objective of covering companies from as many jurisdictions as possible when the new regime started to operate.

33. The Panel noted that while the securities industry in general considered that the proposal would enhance investor protection and investors' choice, there was concern about increase in business costs arising from investment in new system infrastructures and provision of additional services to clients. Some members also called on the Administration to provide incentives to encourage investors to hold their shares in an uncertificated form and ensure that the fees to be charged on investors would not be higher than those of the existing paper-based regime.

34. The Administration pointed out that HKSCC and the share registrars would need to establish new system infrastructures under their respective purviews in order to tie in with implementation of the regime and bear the costs involved. On fees to be charged by a recognized exchange, it would be subject to the approval of SFC, and under the Securities and Futures Ordinance (Cap. 571) ("SFO"), SFC would decide fees approval having regard to, amongst others, the level of fee imposed by similar bodies outside Hong Kong for the same or similar matter. As regards fees to be charged by individual share registrars, it was expected that they would be driven by market forces to acceptable levels. SFC would work with HKSCC and share registrars to enhance understanding of market participants on the setting of fees. The Administration/SFC would communicate with the securities industry on details for implementing the proposed regime including the relevant system requirements, and strive to reduce the costs on the trade.

35. Panel members noted that the Administration introduced the Securities and Futures and Companies Legislation (Uncertificated Securities Market Amendment) Bill 2014 into LegCo in June 2014 to provide for the proposed regime.

<u>Development of the financial services industry in Hong Kong</u>

Work of the Financial Services Development Council

36. The Panel received a briefing on the work progress of the Financial Services Development Council ("FSDC") at the meeting on 6 January 2014. On the timeframe for taking forward the various recommendations in the first batch of six reports published by FSDC in November 2013, the Panel noted the Administration's views that as FSDC's recommendations would have implications on the regulatory regimes and taxation system in Hong Kong, time would be needed for the Administration to consider them carefully and, where

appropriate, consult the industry. At the Panel's request, the Administration agreed to provide information on the Government's responses to FSDC's recommendations put forward in the reports, including the Government's initial plans in taking them forward and the timetables concerned.

37. Whilst expressing support for Hong Kong to continue to capture market opportunities from the Mainland in further developing its financial services industry, members emphasized the importance for Hong Kong as an international financial centre to ensure proper regulation of financial activities and maintain market stability. Some members also suggested FSDC to study measures for improving the business environment for SMEs in the financial services sector and help them to access the Mainland market.

38. FSDC stressed that Hong Kong's regulatory regime was sound in general, and all listed entities in Hong Kong, irrespective of their place of incorporation or status as State-owned enterprises or otherwise, were required to comply with the Listing Rules and other relevant regulatory requirements. As regards the needs and interests of SMEs, FSDC recognized their contributions in the development of the financial services industry in Hong Kong, and considered that expansion of business opportunities in the Mainland would certainly benefit the financial services sector across the board. The Panel noted that FSDC would continue to gauge the industry's views on ways to enhance human capital for future development of Hong Kong's financial services sector. Enhancement in human capital and manpower training would benefit SME firms which might encounter resources constraints in this area.

Development of the asset management industry

39. In order to promote further development of the asset management industry in Hong Kong, the Administration proposed to introduce a new proposed open-ended fund companies ("OFC") structure to enhance Hong Kong's legal infrastructure for investment fund vehicles. The Administration launched a three-month public consultation in March 2014 on the OFC proposal and briefed the Panel on 7 April 2014.

40. The Panel welcomed the OFC proposal in general in attracting various types of funds to Hong Kong and consolidating Hong Kong's position as an international financial centre. On the proposed tax regime for OFCs, while some members supported providing more tax incentives for OFCs to attract overseas funds to domicile in Hong Kong, e.g. exempting profits tax of publicly offered OFCs and that of privately offered OFCs with central management and control ("CMC") located onshore, some members expressed reservation on concerns about potential loss of tax revenue and creating an unlevel playing field between the trading of fund products vis-à-vis that of stocks which were subject to tax.

41. The Administration explained that taxation would be among the factors considered by market participants in making decisions on fund domicile. Currently, privately offered OFCs with CMC located offshore were already exempted from profits tax, which was in line with the existing profits tax exemption available to all offshore funds. As regards privately offered OFCs with CMC located onshore, it was observed that some fund jurisdictions offered profits tax exemption to such funds. The Administration would consider the exemption proposal carefully taking into account overseas practices, suggestions from LegCo Members and the public during consultation, as well as possible implications of the proposal.

42. Members stressed the need to ensure adequate protection for investors under the OFC regime. The Administration assured that there would be appropriate measures to protect investors' interests including, eligibility requirements on OFC investment manager and custodian, proper segregation of assets of OFCs, statutory and fiduciary duties imposed on OFC directors, etc. In respect of the investment of OFCs, the initial thinking was that an OFC would invest in asset classes broadly in line with those of a traditional investment fund within the remit of SFO, and aligned with those types of investment activities which were subject to licensing and regulation by SFC under SFO. Publicly offered OFCs would need to comply with the applicable SFC product codes, including requirements for diversification of investment and risk disclosure.

Briefing by the Financial Reporting Council

43. The Panel received the annual briefing on the work of the Financial Reporting Council ("FRC") at the meeting on 5 May 2014. The Panel welcomed the Administration's initiative to implement a reform to enhance the independence of Hong Kong's auditor regulatory regime. Noting that FRC had been assisting the Government in developing the reform proposals, members enquired about FRC's consultation with the auditing industry on the subject. FRC advised that the Independent Audit Oversight Reform Committee was formed to advise the Council of FRC on matters relating to the reform. FRC also commissioned an international comparative study on the subject and published the consultancy findings in October 2013. FRC would continue to collaborate with the Administration in arousing public awareness on the available options for reform.

44. As the recent internal consultation conducted by Hong Kong Institute of Certified Public Accountants revealed that stakeholders had expressed different views and concerns about the reform, members urged the Administration to gauge the views of different stakeholders, including the auditing profession, regulators and listed companies extensively, and establish a

consultative committee comprising representatives from stakeholder groups to work out the reform proposals. The Panel noted that the Government launched a three-month public consultation on the reform in June 2014.

Mandatory Provident Fund System

Mandatory Provident Fund Schemes (Amendment) Bill 2014

45. The Administration and the Mandatory Provident Fund Schemes Authority ("MPFA") briefed the Panel on 5 May 2014 on the key legislative proposals under the Mandatory Provident Schemes (Amendment) Bill 2014. On the proposal of allowing MPF scheme members to withdraw accrued benefits before the age of 65 if they suffered from a terminal illness that reduced their remaining life expectancy to 12 months, some members were of the view that the "12-month life expectancy yardstick" was too harsh and considered that it should suffice for a scheme member to provide a medical certificate that he/she was suffering from terminal illness or a certain late stage of terminal illness in justifying the early withdrawal. Moreover, some members urged the Administration to consider allowing early withdrawal of MPF accrued benefits by scheme members for meeting expenses on medical examination, treatment or surgery which was essential to enable early diagnosis and healing of terminal illness.

46. The Administration stressed the need to put in place an easy-to-understand and objective definition of terminal illness so as to ensure effective and efficient administration of the claim procedure. The "12-month life expectancy yardstick" was proposed with reference to the same yardstick adopted for similar purposes in the Australian Superannuation System. It was also the outcome of the public consultation conducted in December 2011 and subsequent intensive discussion with medical professional bodies. On the suggestion of allowing early withdrawal of MPF benefits to meet medical expenses, the Administration considered that this would mean less accrued benefits for retirement protection of scheme members given that the MPF system was a dedicated scheme designated exclusively for retirement benefits for the workforce in Hong Kong and the rate of contribution was relatively low. The Panel noted the Administration's undertaking to keep under review the scope of the grounds for early withdrawal in future review exercises.

47. Regarding the proposal of allowing scheme members to withdraw MPF accrued benefits by instalments upon retirement and early retirement, some members suggested that the Administration/MPFA should consider allowing withdrawal of MPF benefits on a monthly basis free of charge in order to facilitate elderly scheme members and provide more choices for scheme members on the withdrawal arrangements. The Administration explained that higher frequency of withdrawals would result in higher administrative costs.

In light of the views of Panel members, the Panel noted that the Administration had further liaised with the industry on the free-of-charge phased withdrawal arrangement and amended the proposal to require trustees to process free of charge a scheme member's request to make withdrawal no more than 12 times a year, with no restrictions on the amount withdrawn.

48. In respect of the proposal to tighten MPFA's approval of new MPF schemes and constituent funds, while concurring that this would avoid proliferation of fund choices which would not be conducive to fee reduction, some members cautioned that MPFA should not refuse applications for new schemes/funds indiscriminately as it would be in the interest of scheme members to approve schemes/funds with relatively lower fees and ensure the provision of a range of schemes/funds offering genuine choices to scheme members. The Panel noted that MPFA would ensure that only scheme/funds which would be beneficial to scheme members, such as schemes/funds with reduced fees, would be approved, and appeal mechanism was available for applicants of new MPF schemes/funds to appeal against MPFA's decisions of refusing applications.

The arrangement of offsetting severance payments and long service payments against MPF accrued benefits

49. In view of divergent views from relevant stakeholders on whether the current arrangement allowing employers to offset severance payments ("SP") SP and long service payments ("LSP") against MPF accrued benefits ("the offsetting arrangement") should be abolished, and given that the subject straddled the purviews of the Panel and the Panel on Manpower, the two Panels held a joint meeting on 18 March 2014 to receive views from deputations and discuss with the Administration on related issues.

50. At the joint meeting, members of the two Panels noted that employee's bodies expressed grave concern about the offsetting arrangement reducing employees' accrued benefits and thus defeating the purpose of the MPF system in providing retirement protection for the workforce. Some labour bodies called on the Administration to adopt a decisive stance to abolish the offsetting arrangement and devise a concrete work plan and a timetable to phase-out the arrangement. On the other hand, Panel members noted the strong objection from the employer's organizations. They stressed that the offsetting mechanism was a consensus reached after extensive consultations in enacting the MPF legislation, and that employer's organizations agreed to support implementation of the MPF System on the understanding that the law would permit the offsetting arrangement. Abolition of the offsetting arrangement would amount to a breach to such consensus. Moreover, employers were concerned that abolition of the offsetting arrangement would increase their financial burden, especially those of SMEs.

51. As the subject was of major concern to the community, and having regard to the wide implications on the interests of employees and employers as well as the divergent views expressed by both sectors, members of the two Panels considered that the Administration must consider the matter in a prudent manner. On the way forward, members noted that the Administration would continue to listen to the views of relevant stakeholders and consider and examine the issue in a holistic and careful manner.

Long-term fiscal planning of Hong Kong

52. FS appointed the Working Group on Long-term Fiscal Planning ("the Working Group") in June 2013 to explore ways to make more comprehensive planning for Hong Kong's public finances in coping with the ageing population and the associated longer term financial commitments. The Working Group released its report in March 2014 which pointed out that a structural deficit might surface sooner or later if government expenditure continued to grow faster than its revenue. The Working Group considered that the Government should tighten its fiscal discipline and recommended adoption of a package of measures to cope with the fiscal challenges ahead.

53. The Panel exchanged views with the Working Group on issues related to long-term fiscal planning of Hong Kong at the meeting on 7 April 2014. With the Working Group's forecast that a structural deficit problem might surface in seven to 15 years' time, members conveyed the grave concern of the public that the Government might suppress demand for enhancement of public services under the pretext of containing expenditure growth. Members considered it a priority for the Government to promote economic development in addressing the possible structural deficit problem in future. In this regard, members suggested the Administration to take various measures including, increasing capital investment, improving the business environment, identifying new revenue sources to broaden its revenue base, making better use of the fiscal reserves and the Accumulated Surplus of EF, importing labour to Hong Kong to enhance its productivity, as well as pursuing reclamation to increase land supply to support economic development.

54. The Administration stressed that, while it was necessary to keep the budget commensurate with GDP growth, the Government reckoned the need to meet community aspirations for public services and would continue to enhance the quality and cost-effectiveness of services as necessary. Regarding the structural deficit problem, the Working Group took the view that the Government should adopt a multiple-pronged approach to tackle the problem. Besides exploring means to broaden government revenue base, the Working Group considered that the Government should enhance utilization of EF's investment returns, examine options for partnerships with the private sector and enlist the support of the whole community in implementing the recommended

fiscal measures. The report of the Working Group would facilitate a more focused discussion by the community on issues relating to Hong Kong's fiscal sustainability and measures to promote economic growth.

55. Concerning the Working Group's recommendation to establish a Future Fund ("FF"), some members queried the motive behind and sought further details on the usage, management, and investment of the Fund. The Working Group advised that it had made reference to the experiences of Australia and Norway which had created funds for stabilization or savings purposes catering their unique circumstances. The FF would not be accounted for as part of the fiscal reserves, and its investment could be segregated from the fiscal reserves placed with EF. Moreover, a more aggressive and longer-term investment strategy could be adopted to yield higher returns. As to whether the FF should be established with designated uses, the Panel noted the Government's initial thinking that the Fund should be used to finance non-recurrent initiatives, in particular capital works projects, such as hospitals and elderly homes which were closely related to improvement of people's livelihood and meeting the needs of the ageing population. The Panel noted that FS had requested the Working Group to conduct further studies on the proposal regarding the FF and measures to step up the management of Government's assets with a view to enhancing investment returns and operational cost effectiveness. The Working Group would submit a further report within the financial year 2014-2015.

<u>Other work</u>

56. During the 2013-2014 legislative session, the Panel also discussed with the Administration on the following subjects:

(a) legislative proposals, including reform approaches for the abscondee regime under the Bankruptcy Ordinance (Cap. 6), proposed legislation to enable the issuance of Islamic bonds under the Government Bond Programme, enhancement of the existing tax appeal mechanism, and the Inland Revenue (Amendment) (No.3) Bill 2013;

(b) establishment proposals, including creation/retention of supernumerary directorate posts to deal with matters concerning network of exchange of information arrangements of Hong Kong, work at the Stamp Office of the Inland Revenue Department, financial cooperation with the Mainland, financial regulation and financial system stability, corporate insolvency, auditor regulatory reform, bankruptcy administration, the new Companies Ordinance (Cap. 622), the reformed trust law, anti-money laundering regime, and regulation of relevant mandatory provident fund intermediaries;

(c) funding proposals, including the plan for 2016 population by-census, organization of the Asia-Pacific Economic Cooperation Finance Ministers' Meeting 2014 in Hong Kong, construction of West Kowloon Government Offices, and development of dutiable commodities system in the Customs and Excise Department;

(d) briefing by FS on the launch of the public consultation on the 2014-15 Budget; and

(e) briefing by the Secretary for Financial Services and the Treasury on the relevant policy initiatives in the Chief Executive's 2014 Policy Address.

57. From October 2013 to June 2014, the Panel has held a total of 11 meetings, including a joint meeting with the Panel on Manpower.

Council Business Division 1
Legislative Council Secretariat
2 July 2014

Appendix I

Legislative Council

Panel on Financial Affairs

Terms of Reference

1. To monitor and examine Government policies and issues of public concern relating to financial and finance matters.

2. To provide a forum for the exchange and dissemination of views on the above policy matters.

3. To receive briefings and to formulate views on any major legislative or financial proposals in respect of the above policy areas prior to their formal introduction to the Council or Finance Committee.

4. To monitor and examine, to the extent it considers necessary, the above policy matters referred to it by a member of the Panel or by the House Committee.

5. To make reports to the Council or to the House Committee as required by the Rules of Procedure.

Appendix II

Legislative Council
Panel on Financial Affairs

Membership list for 2013 - 2014 session

Chairman	Hon Starry LEE Wai-king, JP
Deputy Chairman	Hon Christopher CHEUNG Wah-fung, SBS, JP
Members	Hon Albert HO Chun-yan Hon James TO Kun-sun 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 James TIEN Pei-chun, GBS, JP Hon NG Leung-sing, SBS, JP Hon Kenneth LEUNG Hon Dennis KWOK Hon SIN Chung-kai, SBS, JP
	(Total：18 members)
Clerk	Ms Connie SZETO
Legal Adviser	Mr YICK Wing-kin