立法會
Legislative Council

LC Paper No. CB(1)781/14-15
(These minutes have been seen by the Administration)

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Panel on Financial Affairs

Minutes of meeting
held on Monday, 2 February 2015 at 8:45 am
in Conference Room 1 of the Legislative Council Complex

Members present :	Hon CHAN Kin-por, BBS, JP (Chairman) Hon Christopher CHEUNG Wah-fung, SBS, JP (Deputy Chairman) Hon James TO Kun-sun Hon CHAN Kam-lam, SBS, 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 Starry LEE Wai-king, 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
Members attending :	Hon LEE Cheuk-yan Dr Hon LAM Tai-fai, SBS, JP
Members absent :	Hon Albert HO Chun-yan Hon Abraham SHEK Lai-him, GBS, JP

Public officers attending :

Agenda item III

Prof K C CHAN, GBS, JP
Secretary for Financial Services and the Treasury

Mr Andrew WONG, JP
Permanent Secretary for Financial Services and the Treasury (Financial Services)

Ms Elizabeth TSE, JP
Permanent Secretary for Financial Services and the Treasury (Treasury)

Mr James LAU, JP
Under Secretary for Financial Services and the Treasury

Mr Eddie CHEUNG
Deputy Secretary for Financial Services and the Treasury (Financial Services) 2

Mr Patrick HO, JP
Deputy Secretary for Financial Services and the Treasury (Financial Services) 3

Agenda items III and V

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

Agenda item IV

Mr Norman CHAN, GBS, JP
Chief Executive
Hong Kong Monetary Authority

Mr Peter PANG, JP
Deputy Chief Executive (Development)
Hong Kong Monetary Authority

Mr Eddie YUE, JP
Deputy Chief Executive (Monetary)
Hong Kong Monetary Authority

Mr Arthur YUEN, JP
Deputy Chief Executive (Banking)
Hong Kong Monetary Authority

Attendance by invitation : <u>Agenda item V</u>

<u>Securities and Futures Commission</u>

Mr Carlson TONG, SBS, JP
Chairman

Mr Ashley ALDER, JP
Chief Executive Officer

Mr Andrew WAN
Chief Financial Officer and Senior Director, Corporate Affairs

Mr Paul YEUNG
Commission Secretary

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

Staff in attendance : Ms Angel SHEK
Senior Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

I Information papers issued since the last meeting

(LC Paper No. CB(1)399/14-15(01) — Letter from the Financial Secretary's Office on rescheduling of briefing on Hong Kong's latest economic situation and Budget consultation)

Members noted the information paper issued since the last regular meeting held on 5 January 2015.

II Date of next meeting and items for discussion

(LC Paper No. CB(1)445/14-15(01) — List of outstanding items for discussion

LC Paper No. CB(1)445/14-15(02) — List of follow-up actions)

2. Members agreed to discuss the following items proposed by the Administration at the next regular meeting scheduled for 2 March 2015:

(a) Second stage of public consultation on establishing an effective resolution regime for financial institutions in Hong Kong; and

(b) Review of the adjustment mechanism for the Minimum and Maximum Levels of Relevant Income for Mandatory Provident Fund ("MPF") mandatory contributions.

III Briefing by the Secretary for Financial Services and the Treasury on relevant policy initiatives in the Chief Executive's 2015 Policy Address

(LC Paper No. CB(1)445/14-15(03) — Administration's paper on 2015 Policy Address - Policy Initiatives of the Financial Services and the Treasury Bureau

— Address by the Chief Executive at the Legislative Council meeting on 14 January 2015)

Briefing by the Administration

3. The Secretary for Financial Services and the Treasury ("SFST") briefed Members on the policy initiatives of the Financial Services and the Treasury Bureau ("FSTB") featured in the Chief Executive ("CE")'s 2015 Policy Address by highlighting the following areas of work set out in the Administration's paper (LC Paper No. CB(1)455/14-15(03)):

(a) advancing financial cooperation with the Mainland and offshore Renminbi ("RMB") business (e.g. enhancing mutual stock market access between Hong Kong and Shanghai through the Shanghai-Hong Kong Stock Connect ("S-HK SC"));

(b) consolidating Hong Kong's position as the premier asset management centre in the Asia-Pacific region (e.g. introduction of a new open-ended fund company structure, extension of profits tax exemption for offshore funds to private equity funds in respect of transactions in private companies incorporated outside Hong Kong, and waiving the stamp duty for transfer of all exchange traded funds);

(c) attracting corporations to manage treasury activities in Hong Kong and developing the local bond market;

(d) implementing international standards and enhancing the regulatory regime for the financial sector (e.g. implementation of a regulatory regime for the over-the-counter ("OTC") derivatives market; development of an effective cross-sectoral resolution regime for financial institutions, implementation of the second phase of Basel III requirements, and improvement to the regulatory regime for listed entity auditors);

(e) review of abscondee regime under the Bankruptcy Ordinance (Cap. 6), improving the corporate insolvency laws and introducing a statutory corporate rescue procedure;

(f) enhancing financial infrastructure (e.g. introduction of an uncertificated securities market regime and regulatory regime for stored value facilities ("SVF") and retail payment systems ("RPS"));

(g) establishment of an independent Insurance Authority ("IIA");

(h) enhancing the MPF system and introducing "Core Fund" as a default investment arrangement under an MPF scheme; and

(i) expanding Hong Kong's network of comprehensive avoidance of double taxation agreements, and putting in place necessary domestic legislation to facilitate automatic exchange of financial account information ("AEOI") in tax matters.

(*Post-meeting note*: The press release containing the speaking note of SFST (Chinese version only) was issued to members vide LC Paper No. CB(1)506/14-15(01) on 4 February 2015.)

Discussion

Shanghai-Hong Kong Stock Connect

4. Mr Jeffrey LAM enquired about measures to improve/enhance S-HK SC in the light of operational experience in the past two months, and the timetable, if any, for taking forward the Shenzhen-Hong Kong Stock Connect ("SZ-HK SC"). Mr Christopher CHEUNG appreciated the Administration's efforts in implementing S-HK SC which was an important milestone in the development of the local financial market. He believed that the turnover under S-HK SC would increase over time, and S-HK SC and the future SZ-HK SC would further strengthen financial cooperation between Hong Kong and the Mainland.

5. SFST said that operation of S-HK SC was generally smooth since the implementation in November 2014. As observed, transactions under S-HK SC had grown as investors gained more experience in the trading. He explained that the prescribed quotas for S-HK SC were deliberately set at a high level in order not to trigger frequent suspension of trading when the quotas were reached. He added that the Administration would continue to enhance S-HK SC in areas such as the short selling regime and scope of eligible securities, with a view to attracting more investors to use S-HK SC. As regards preparation for SZ-HK SC, SFST said that the relevant authorities of both sides were discussing the details.

6. Mr Christopher CHEUNG suggested removing the current requirement for payment of the Mainland Settlement Deposit (determined daily at the rate of 20%) by investors or their agents for trading of eligible shares listed on the Shanghai Stock Exchange ("SSE") under S-HK SC as the measure had exerted liquidity pressure on small and medium-sized securities

firms because they might need to pay the Deposit on behalf of their clients. He pointed out that since transactions were settled in cash and the securities were held at the stock exchange the associated risks were low and therefore did not warrant collection of the Deposit. SFST explained that collection of the Mainland Settlement Deposit was part of the risk management measures under S-HK SC. He agreed to relay Mr CHEUNG's suggestion to the relevant authorities for consideration.

(*Post-meeting note*: The Administration's written response was issued to members vide LC Paper No. CB(1)581/14-15(02) on 25 February 2015.)

7. Given that further enhancement in mutual stock market access between Hong Kong and the Mainland would allow more Hong Kong investors to trade Mainland-listed securities, Mr SIN Chung-kai enquired about the investor protection and education measures in respect of S-HK SC. He urged the need for the Administration to enhance awareness of Hong Kong investors of the different regulatory regimes over listed companies in the Mainland and Hong Kong including the relevant disclosure requirements, as well as the risks associated with stock trading through S-HK SC.

8. SFST said that access to the Mainland securities market was restricted and controlled, and S-HK SC provided a channel for Hong Kong investors to trade eligible SSE-listed securities. The operation of S-HK SC was different from the securities markets in the United States ("US"), United Kingdom, or Hong Kong which were open markets. SFST stressed that investor protection was a top priority in the implementation of S-HK SC and the relevant authorities of both sides had deployed substantial resources to strengthen investor education in respect of S-HK SC. For instance, the Investor Education Centre ("IEC") had organized a series of workshops to enhance Hong Kong investors' understanding of the operation of the Mainland securities market. Investors should be vigilant of the unique risks associated with each financial market when making investment. On cross-boundary enforcement, SFST advised that the China Securities Regulatory Commission ("CSRC") and the Securities and Futures Commission ("SFC") had upgraded their bilateral agreement to strengthen enforcement and investigatory cooperation. It was also observed that the Mainland authorities had stepped up their efforts in bringing the regulatory regime for listed entities on par with international standards.

9. As regards Mr SIN Chung-kai's enquiry about the channel for Hong Kong investors to lodge complaints about trading of SSE-listed securities, SFST said that CSRC, as the regulator of the Mainland securities markets, was the authority to receive and handle such complaints. If necessary, SFC would

refer received complaints to CSRC for follow-up as appropriate. At the request of Mr SIN, SFST agreed to provide supplementary information on:

(a) possible risks on Hong Kong investors involved in cross-boundary stock trading through S-HK SC, and the measures to protect investors and enhance their awareness of such risks;

(b) regulatory and disclosure requirements on SSE-listed companies imposed by CSRC; and

(c) channels/procedures for lodging complaints with CSRC by Hong Kong investors and the mechanism of handling such complaints by CSRC.

(*Post-meeting note*: The Administration's written response was issued to members vide LC Paper No. CB(1)581/14-15(02) on 25 February 2015.)

Offshore RMB business

10. Mr Andrew LEUNG expressed concern about rising risks of RMB derivatives arising from increasing fluctuation of the currency in recent months with strengthening of the US Dollar, and cautioned that the Government should ensure proper regulation of RMB derivatives.

11. SFST responded that the two-way fluctuation of RMB was conducive to the development of RMB-related products including RMB derivatives. He said that Hong Kong's regulatory requirements on derivatives products were relatively stringent compared to other jurisdictions, and there was an increasing trend for RMB derivatives to be traded over the counter than on the exchange. To enhance the regulation of derivatives products, a regulatory regime for OTC derivatives market in Hong Kong was put in place in 2014 to require for mandatory reporting, clearing and trading of OTC derivatives transactions, etc. The new regime would enhance investor protection in the trading of RMB derivatives off the exchange.

12. Referring to the Mainland policy to create a global network of offshore RMB clearing and the setting up of RMB clearing banks in London, Paris, Singapore and Sydney, etc., Mr NG Leung-sing enquired about the Administration's strategies/measures to capitalize on the internationalization of RMB and reinforce Hong Kong's position as a premier offshore RMB business centre.

13. SFST said that expansion of RMB global clearing network had opened up new opportunities for Hong Kong on RMB business as well as brought competition among the offshore RMB business centres. He believed that with the relatively large offshore RMB liquidity pool in Hong Kong, Hong Kong would continue to play an unique and strategic role in RMB clearing. Going forward, the Administration would maintain close communication with the relevant Mainland authorities to enhance and promote Hong Kong's offshore RMB business.

14. Mr Jeffrey LAM sought assessment of the potential impacts on the stability of the Hong Kong Dollar and the Linked Exchange Rate ("LER") arising from appreciation of the US Dollar against RMB recently. SFST pointed out that LER was an important anchor to maintain stability of Hong Kong's Monetary Base. LER had enabled Hong Kong to adjust to the shocks stemming from the financial crisis in 2008 and averted a sudden collapse of the Hong Kong Dollar. While strengthening of the US Dollar had caused some fluctuations in the Hong Kong Dollar, it was observed that Hong Kong's banking system and the economy at large were able to cope with the fluctuations so far.

Development of the financial services industry

15. Noting that the Financial Services Development Council ("FSDC") had put forward a number of recommendations in its research reports to further develop Hong Kong's financial services industry, Mr CHAN Kam-lam enquired about the Administration's timetable in taking forward the various proposals. He stressed the importance to implement FSDC's proposals timely as circumstances in the global and local financial markets were subject to rapid changes.

16. SFST said that FSDC was an important advisory body set up by the current term Government for further development of Hong Kong's financial services industry. Among the various proposals put forward by FSDC, some concrete ones, such as extending the profits tax exemption for offshore funds to private equity funds, could be readily pursued when the necessary legislative amendments were in place. Some proposals would hinge on the relevant Mainland policies and its pace of financial market liberalization. It was necessary for the Government to observe the developments in related issues in considering the plans and timing for implementing these proposals.

17. Ms Starry LEE shared that the financial services industry was an important pillar of the Hong Kong economy, and stressed the need for Hong Kong to maintain its competitiveness vis-à-vis other financial centres. She enquired about the proposals in respect of the financial services industry put

forward by the Government in relation to the National 13th Five-Year Plan, including measures to leverage on the development of Qianhai and further the cooperation with Mainland free trade zones ("FTZs") for advancing the development of Hong Kong's financial sector.

18. SFST said that the proposals put forward by the Hong Kong Government for the National 13th Five-Year Plan were mainly related to the strategies and means to complement development of the Mainland economy under the Plan. He pointed out that there would be great business opportunities for Hong Kong to act as a platform for the financing, investment and treasury activities of Mainland enterprises in facilitating their objective of "going global". As regards FTZs set up in the Mainland, SFST remarked that they would provide business opportunities rather than pose challenges to Hong Kong. In particular, FTZs had facilitated the pooling of capital of Mainland enterprises, and Hong Kong could play an instrumental role in the management of the enterprises' offshore treasury activities.

19. Mr Andrew LEUNG stressed the importance to strike a proper balance between market regulation and development in order to ensure healthy development of Hong Kong's financial services industry. The Chairman expressed concern about possible increase in compliance costs on the insurance industry arising from new regulatory requirements, in particular following the establishment of IIA and a Policyholders' Protection Fund in the future. He concurred that the Administration should strike a balance between enhancing regulation and development of the insurance industry.

20. SFST responded that while it was a policy objective to enhance regulation of the local financial market as appropriate having regard to latest international requirements and practices, the Administration was mindful of the need to avoid excessive regulation hindering market development. In introducing new regulatory initiatives, FSTB would carefully consider the feasibility of the proposals taking into account industry needs and views as well as the relevant international developments.

Development of asset management industry and attracting corporations to manage treasury activities in Hong Kong

21. On the initiative to attract corporations to set up corporate treasury centres in Hong Kong, Mr CHAN Kam-lam enquired about the timeframe for the Administration to complete its study on proposals in this respect and whether such proposals would include measures other than tax incentives. Ms Starry LEE and Mr Kenneth LEUNG enquired about the specific measures under consideration by the Administration and the progress made so far. Mr Christopher CHEUNG said that the brokerage industry in general

welcomed the development of treasury management in Hong Kong to provide new business opportunities for securities brokers.

22. SFST said that the Financial Secretary ("FS") announced in the 2014-2015 Budget speech the setting up of a task force to review the requirements under the Inland Revenue Ordinance (Cap. 112) for interest deductions in the taxation of corporate treasury activities, and to clarify the criteria for such deductions. The proposals under study were related to such taxation measures and how they could help attract corporations to manage their treasury activities in Hong Kong while preserving the tax revenue for Hong Kong. SFST said that the study concerned was near completion and the Administration would consult the Panel on the relevant proposals in due course.

23. Mrs Regina IP agreed that the Government should attract more corporations to set up treasury centres in Hong Kong. She observed that "sale of fund products" rather than "management of assets" was the main component of the current local asset management industry. She further noted that asset management companies were inclined to recruit Mainland talents, and local graduates were facing fierce competition from Mainland counterparts in finding jobs in the financial services industry. Mrs IP considered it necessary for the Administration to strengthen the competitiveness of the local graduates in preparing for new opportunities in the asset and treasury management sector. She also suggested that the Administration should appeal to the Mainland/foreign investment corporations to recruit more local talents.

24. SFST advised that the Administration's policy objective was to diversify and expand the local asset management industry. Among other measures, the Administration and SFC were discussing with CSRC on the mutual recognition of funds between Hong Kong and the Mainland, under which Mainland funds domiciled in and operating from Hong Kong would be qualified as "recognized Hong Kong funds". This measure would help attract more fund managers and financial companies to set up offices in Hong Kong for business operation or fund management, and in turn would drive the demand for related professional services. SFST considered that there was sufficient supply of local talents in the field of asset management and treasury business. With closer financial cooperation between Hong Kong and the Mainland, it was inevitable that there would be growing demand for Mainland talents. SFST pointed out that with the continuous development of the local asset management industry, it was envisaged that there would be an increasing demand for talents for front office as well as middle/back office positions. The challenge was to attract talents work in the perceived "less attractive" fields (e.g. legal compliance and middle/back office and operations) vis-à-vis the more attractive jobs (e.g. investment banking). As highlighted in FS'

2014-2015 Budget speech, the Administration would follow up on measures to develop Hong Kong's human capital in financial services, and enhance public awareness of the types of jobs across the financial sector.

25. With a view to enhancing Hong Kong's position as an asset management centre, Mr Christopher CHEUNG suggested that SFC should consider relaxing or waiving the licensing requirements for intermediaries licensed for Type 1 regulated activity ("RA") to conduct Type 9 RA (i.e. asset management) if they had equivalent experience in asset management such as handling of discretionary accounts. He expressed concern that under the current arrangement, the relevant experience of practitioners was not recognized when they applied for Type 9 RA licence, and it would take as long as a year for experienced practitioners to go through the requisite course(s) and examination(s) for obtaining the licence. SFST said that he would relay Mr CHEUNG's suggestion to SFC for consideration.

(*Post-meeting note*: The Administration's written response was issued to members vide LC Paper No. CB(1)581/14-15(03) on 25 February 2015.)

26. Mr Christopher CHEUNG expressed concern about the abrupt suspension of the Capital Investment Entrant Scheme announced by CE in the 2015 Policy Address. Pointing out that the Scheme had attracted investment of over $100 billion to Hong Kong in the past decade and helped the development of Hong Kong's asset management industry, Mr CHEUNG enquired if the Administration would conduct a review for re-launching the Scheme later. SFST said that the objective of the Scheme was mainly to attract talents (and not investment) from outside Hong Kong. After taking into account a number of factors and other measures already in place or to be implemented, the Administration considered it appropriate to suspend the Scheme. The Administration would assess the impacts of the suspension before considering the way forward.

Mandatory Provident Fund system

27. Mr WONG Kwok-hing said that CE had pledged in his Election Manifesto to progressively reduce the proportion of employers' contributions to the MPF scheme that could be used to offset severance payment or long service payment to employees ("SP/LSP offsetting arrangement"). As there were only some two years left before the end of CE's current term of office, Mr WONG expressed concern about how FSTB would tackle the matter. Mr LEE Cheuk-yan criticized that the Administration had procrastinated the matter by repeatedly claiming that the issues involved were complicated and required

further study. He urged the Administration to uphold CE's pledge to abolish the SP/LSP offsetting arrangement.

28. SFST responded that the SP/LSP offsetting arrangement was complicated and involved the interests of both employers and employees. As the community had not yet reached a consensus on the matter, the bureaux concerned would continue to study related issues and listen to the views of stakeholders before determining the way forward. In the meantime, FSTB and the Mandatory Provident Fund Schemes Authority ("MPFA") would continue to enhance the MPF system.

Expenditures on public works projects

29. Mr WONG Kwok-hing expressed grave concern about the present situation of under spending of expenditure on public works projects as he noted that funding allocation for a number of projects had yet to be approved by the Finance Committee ("FC"). As he understood, FC had only approved some $3.6 billion-worth new public works projects in the 2013-2014 legislative session. He was concerned that the unspent amount might be mistaken as "surplus" in the 2015-2016 Budget, and called on the Government to explain the matter clearly to the public to avoid misunderstanding. He further enquired about the original forecasted funding allocation for new public works items in the 2013-2014 session, and the allocation the Administration planned to submit to FC in the 2014-2015 session.

30. The Permanent Secretary for Financial Services and the Treasury (Treasury) ("PS(Try)") advised that in the 2013-2014 legislative session, FC approved at an estimated cost of $3.6 billion in total for new public works projects, vis-à-vis the amount of $90 billion in the 2012-2013 legislative session. She said that notwithstanding fluctuations in the estimated expenditure on new public works items between years, the estimated annual allocation was over $50 billion on average. Although the Public Works Subcommittee ("PWSC") had endorsed the allocation of funds for some works items in the 2014-2015 legislative session, the relevant funding applications were pending FC's approval as FC was still deliberating on the items carried over from the 2013-2014 legislative session.

31. SFST said that the Government had expressed concern on a number of occasions about the slow progress in the vetting and approval of public works items by FC. He cautioned that deferred funding approval would result in project delays and project cost increases, as well as necessitate adjustment of cash flow. Moreover, re-tendering might be required for some works items as the tender validity periods would expire should the funding applications for the public works items concerned not approved in time. Re-tendering would have

significant impacts on the work completion schedule and likely the project costs. SFST further pointed out that the adverse impact on cash flow arising from substantial reduction in the number of newly approved works items in 2013-2014 and 2014-2015 legislative sessions had yet to be fully reflected in the 2015-16 Budget as the current cash flow mainly reflected expenditure for ongoing public works items approved in previous years. Whereas the unspent amount of estimated public works expenditure due to delayed approval of public works items would become part of the surplus. In reply to Mr WONG Kwok-hing's enquiry about the tender validity periods of public works projects, PS(Try) advised that the Government had provided the relevant information to PWSC for reference recently. The tendering position of these projects would change from time to time.

32. Mr WONG Kwok-hing reiterated his grave concern that no funding allocation for new public works items had been approved by FC so far in the 2014-2015 session. He strongly condemned the acts of Legislative Council ("LegCo") Members belonging to the opposition camp in delaying the approval of public works projects, and considered that these Members should be held accountable for the adverse consequences, in particular the increase in project costs.

33. Mr Kenneth LEUNG emphasized that FC had the duty to scrutinize each capital works project carefully, including the underlying assumptions on the need and estimated utilization of the public infrastructure concerned and its economic benefits, etc. He stressed that the filibustering activities engaged by some LegCo Members were not meant to derail implementation of all public works projects indiscriminately, and some projects deserved more attention and detailed study because they were closely related to people's livelihood. He added that there were other factors attributing to the increase in project costs apart from project delay. Mr LEUNG remarked that instead of implementing the targeted number of infrastructure projects each year, the Administration should consider other means to stimulate the Hong Kong economy and maintain its sustainability, such as by broadening its economic base.

34. The Chairman pointed out that it was indisputable that filibustering activities were going on in LegCo. Mr Andrew LEUNG said that the Administration should study how to facilitate consideration of funding proposals for public works projects by the relevant Panels and PWSC with a view to expediting FC's process in approving the projects.

35. SFST noted members' views and concerns expressed at the meeting and pointed out that the filibustering activities at PWSC and FC and the backlog of public works items pending FC's approval were mainly given rise by debates over controversial issues involved in some public works items and

the attempt by some LegCo Members to defer or frustrate the approval of these items.

36. Mr LEE Cheuk-yan expressed concern about the recent decision of the Administration to remove four funding proposals from the meeting agenda of FC and incorporate the items under the Appropriation Bill 2015. He considered the act concerned a departure from the established practice/convention and an attempt to bypass FC's approval process. SFST said that the arrangement in question was an option that could be pursued under the Public Finance Ordinance (Cap. 2). He stressed that the Administration paid due respect to the funding application/approval mechanism of FC.

Tax information exchange

37. Noting that the Government had indicated its support to the Organization for Economic Cooperation and Development on the new global standard of AEOI in tax matters, Mr Kenneth LEUNG enquired about the details and the Administration's plan in following up the matter. SFST advised that Hong Kong was committed to implementing the new global standard on AEOI in accordance with the relevant committed time line and within Hong Kong's legal framework. On the condition that Hong Kong could put in place the necessary domestic legislation by 2017, the first automatic information exchanges would commence by the end of 2018. Such exchanges would be conducted on a reciprocal basis with appropriate jurisdictions which could meet relevant requirements on protection of privacy and confidentiality of information exchanged and ensuring proper use of the data. The Government's current target was to work out the specific legislative proposals in 2015 and submit the relevant bill to LegCo in 2016. SFST stressed the importance for Hong Kong to implement AEOI and appealed to LegCo Members for supporting the relevant legislative proposal.

Budget consultation

38. Referring to the cancellation of the Panel's regular meeting on 1 December 2014 at which FS was to brief members on Hong Kong's latest overall economic situation and consult them on the upcoming Budget, Mr LEE Cheuk-yan enquired why the Panel had not re-scheduled another meeting for FS to brief members on the two items. He considered that FS should consult Members on the Budget before its presentation to LegCo.

39. The Chairman said that on his instruction, the Clerk had written to the FS Office for scheduling another meeting for FS on the two items in question. The FS Office subsequently advised in its reply letter that it had timely

disseminated the essential information on Hong Kong's latest economic outlook to the general public on 1 December 2014, and pointed out that given the small window of time available before the Policy Address, a special meeting of the Panel on the two items might not be fruitful. The Chairman further said that the Panel was informed of the matter at the meeting on 5 January 2015 and no member had requested for scheduling another meeting on the two items. He added that as FS would brief Members on the Budget after the delivery at LegCo, Members could exchange views with FS on that occasion.

IV Briefing on the work of Hong Kong Monetary Authority

(LC Paper No. CB(1)445/14-15(04) — Paper provided by the Hong Kong Monetary Authority)

Briefing by the Administration

40. At the invitation of the Chairman, the Chief Executive, Hong Kong Monetary Authority ("CE/HKMA"), the Deputy Chief Executive (Development)/HKMA ("DCE(D)/HKMA"), the Deputy Chief Executive (Banking)/HKMA ("DCE(B)/HKMA") and the Deputy Chief Executive (Monetary)/HKMA ("DCE(M)/HKMA") updated members on the work of HKMA through a powerpoint presentation. Topics included assessment of risks to Hong Kong's financial stability, banking supervision, development of the financial market and Hong Kong as an offshore RMB centre, and investment performance of the Exchange Fund ("EF").

(*Post-meeting note*: The notes of the powerpoint presentation (LC Paper No. CB(1)503/14-15(01)) were issued to members vide Lotus Notes e-mail on 5 February 2015.)

Discussion

Credit growth

41. Noting that the growth in bank loans had moderated further in 2014, Mr Andrew LEUNG expressed concern about difficulties for small and medium-sized enterprises ("SMEs") in obtaining loans and the potential adverse impact of a moderated credit expansion on the Hong Kong economy. Mr NG Leung-sing conveyed the concerns of the banking sector about drastic decline in the annualized credit growth from 22.9% in the first quarter of 2014 to 3.7% in the fourth quarter, and sought HKMA's assessment of the implications on the banking sector.

42. CE/HKMA observed that the credit growth rate was 12.7% in 2014 which had remained relatively stable. Given that banks might set annual targets for their lending business, a slackened growth in the fourth quarter might have reflected early achievement of the targets concerned. CE/HKMA considered that, compared to the situations in US and Europe, the banking sector of Hong Kong was still positive in the consideration of credit facilities for SMEs. As the overall credit demand in 2014 had moderated, banks might be more willing to provide financing for SMEs. The Government had put in place measures under the SME Financing Guarantee Scheme to assist enterprises in obtaining loans in the lending market.

43. DCE(B)/HKMA supplemented that HKMA had discussed with the banking sector about recent changes in the credit growth trend, and noted that the moderated growth was attributable to changes in the credit supply and demand conditions in the market. Following several years of relatively rapid credit expansion, banks were more vigilant of the need to exercise prudence in their management of credit risk and liquidity. Furthermore, it was observed that the relatively rapid credit growth in earlier years was mainly driven by growth in loans for use outside Hong Kong whereas the growth in loans for use in Hong Kong had grown steadily. Along with the recent reduced demand for loans for use outside Hong Kong, it was believed that the banking sector should be able to put more emphasis on credits for use in Hong Kong. DCE(B)/HKMA added that while lending achieved only a single-digit growth rate in the second half of 2014, the development might be more sustainable than a double-digit growth rate in the long run in terms of liquidity risk management.

Global economic and currency environment

44. Referring to the decision of the Swiss National Bank to abandon a minimum exchange rate of Swiss Franc against the Euro and the subsequent volatilities in the currency markets, Mr Andrew LEUNG enquired about the possible impacts on the LER system. CE/HKMA said that unlike the one way exchange-rate peg of the Swiss Franc to the Euro, the operation of LER system in Hong Kong was based on a Currency Board system which was a highly disciplined and rule-based monetary regime. He pointed out that the unpegging of the Swiss Franc to the Euro had not posed significant impacts on the Hong Kong Dollar as evidenced by the continued strong market and public confidence in the LER system.

45. Mr Christopher CHEUNG observed that the financial sector had concerns about volatility in the currency markets resulting from uncertainties of the ending of quantitative easing by US on one hand and the launching of

monetary easing policies by Japan, the Eurozone and some other economies on the other. He sought HKMA's assessment of the impacts of the prevailing "currency war" on the Hong Kong Dollar and RMB, and on the local equity market. He was concerned that depreciation of currencies of some economies together with the prospective US' interest rate rise might accelerate reversal of liquidity flow out of Hong Kong, thereby increasing equity risks.

46. CE/HKMA said that quantitative easing policies implemented by the central banks of some countries would result in depreciation of the currencies concerned. Great fluctuation in a currency could accentuate the risks on or increase the return volatility of the investment in financial assets, which were not beneficial to any financial market or economic entity. As regards the impact of currency volatilities on fund flow, CE/HKMA said that emerging economies used to face pressure of capital outflow when the US Dollar became strong and expectation of US interest rate rise increased, and likewise there would be pressure of fund outflow from the RMB markets and RMB might weaken against the US Dollar in the short run. As long as the fluctuation in the US Dollar exchange rates was within reasonable range, the resulting fund movement might not give rise to much systemic risk. With the LER system in place, the exchange rate of the Hong Kong Dollar to the US Dollar would remain stable.

47. Mr SIN Chung-kai enquired about the potential risks on the RMB deposits in Hong Kong (which amounted to over RMB 1,000 billion in end 2014) should the Mainland follow suit to implement quantitative easing. CE/HKMA said that the increase in RMB deposits in Hong Kong might have different purposes (such as for diversification of investment portfolio by investors) and not solely on speculation of appreciation in RMB. It should be noted that there was a 10% growth in RMB deposits despite depreciation of RMB by 2.4% against the US Dollar in 2014. He considered that many investors perceived that investment return from RMB assets was still attractive over the medium to long term. The impact of a weakening trend of RMB on RMB business in Hong Kong was limited.

48. Dr LAM Tai-fai observed that Hong Kong had been playing a pivotal role in offshore RMB business, and expected further expansion of RMB trade settlement as well as further growth in RMB deposits and financing activities in Hong Kong, in particular with the daily RMB conversion limit for Hong Kong residents removed since November 2014. Referring to the situation of the Macau currency, Dr LAM expressed concern that the Hong Kong Dollar might be marginalized with increasing internationalization of RMB.

49. CE/HKMA said that growing acceptance of RMB as a medium of transaction (in cash or by credit card payment) by the local retail businesses

was to provide convenience to Mainland tourists which in turn would encourage their spending in Hong Kong. The same reason applied to the popularity of the Hong Kong Dollar as a medium of transaction in Macau given the large number of visitors from Hong Kong. CE/HKMA pointed out that it was only normal development that use of RMB would become more common in Hong Kong with the increasing number of inbound tourists from the Mainland and as Hong Kong investors diversified their investment portfolio by placing deposits in RMB. Nevertheless, there was no trend that dealings between local persons in Hong Kong were settled in RMB. Indeed, the amount of Hong Kong Dollar notes in circulation was rising in the past ten years to over $300 billion.

50. Referring to the proposal of the newly elected Greek Government to relax the country's bailout conditions and the unlikelihood that the European Union ("EU") states would agree to the proposal, Mr SIN Chung-kai sought assessment of the risks arising from Greece defaulting on its loans and exiting from EU. CE/HKMA said that Greece was a relatively small economy representing a small percentage of the Gross Domestic Product of the euro area. In his view, the controversial proposal put forth by the Greek Government could give rise to complicated issues as other euro area member states might follow suit in dealing with their own debt repayments. As observed, there were already anti-austerity demonstrations in some euro area states including Spain recently. Compared to the potential impacts of the possible exit of Greece from the euro area, the contagious effects that the euro area states looked to reduce their burden of bailout and the associated budget austerity measures were more worrying for the global financial sector.

51. Mr NG Leung-sing observed that the Aggregate Balance (i.e. the sum of the balances of the clearing accounts of banks kept with HKMA) had stayed high since 2009 and reached some $240 billion in 2014, in great contrast to the average of about $0.6 to $0.7 billion of the earlier years. He enquired about the risk management measures to mitigate a possible sharp fall in the Aggregate Balance due to abrupt changes in liquidity with the ending of US' quantitative easing. CE/HKMA advised that the Aggregate Balance formed part of the Monetary Base of about $1,300 billion at present. He considered that the Currency Board arrangements whereby the Monetary Base would expand or contract in response to capital inflow or outflow respectively and interest rate differential between US and Hong Kong would provide a cushion to counteract capital movement and maintain financial stability in Hong Kong.

Performance of the Exchange Fund

52. Referring to page 25 of the powerpoint on EF's investment income, Mr WONG Kwok-hing expressed concern about the substantial investment

loss of $52.7 billion recorded in foreign exchange, following the successive losses of $3.1 billion, $9.1 billion and $1.4 billion in 2010, 2011 and 2012 respectively. He enquired whether HKMA would consider adjusting the investment strategy and portfolio of EF to reduce the loss. Mr Kenneth LEUNG asked if HKMA would make use of short-term hedging and arbitrage to manage risks associated with the investment in foreign exchange.

53. Mrs Regina IP expressed concern about EF's full-year investment income of $43.6 billion in 2014 which was unsatisfactory as compared to the income of $111.6 billion in 2012 and $81.2 billion in 2013. She enquired about HKMA's strategies to enhance the stability of EF's investment income. Pointing out that some investment funds in the market could perform better than EF, Mr James TIEN queried whether existing statutory requirements on the use of EF had constrained HKMA from taking more aggressive and flexible investment strategies to improve EF's investment return, and whether the reduced investment return was due to payment of large sum of management fees to external investment consultants or fund managers. Mr TIEN stressed the importance to enhance EF's investment income, in particular because the fiscal reserves were placed with EF for making investment, and hence EF's investment return would affect the resources available for the Budget of each financial year.

54. CE/HKMA advised that under the current arrangement with the Government, the return on fiscal reserves placed with EF was calculated based on the average annual rate of return of EF's Investment Portfolio over the past six years with a view to ensuring a stable investment return for the fiscal reserves. The return rate for fiscal reserves placed with EF was 3.6% for 2014, which was higher than the rate of 1.4% for the entire EF for that year. CE/HKMA stressed that unlike sovereign wealth funds or other funds in the market, EF was not an investment fund. Due regard must be given to EF's statutory functions for maintaining the monetary and financial stability of Hong Kong. There was a need to provide full backing to the entire Monetary Base through holding high quality and short-term US Dollar-denominated debt securities with high liquidity in the Backing Portfolio as required under the Currency Board arrangements. In view of EF's statutory functions, it was a primary goal to preserve the principal when considering EF's investment strategies, whereas long-term investment return was only a secondary objective.

55. On EF's income from foreign exchange, CE/HKMA explained that assets in EF were held in different currencies and their investment return, when denominated in Hong Kong Dollar, would fluctuate having regard to cyclical movements of the US Dollar against other currencies. The full-year foreign exchange loss of $52.7 billion in 2014 was mainly attributed to the strong

appreciation of the US Dollar, and accounted for only some 1.7% of EF's total assets of the year. He highlighted that EF recorded investment gains from foreign exchange at 2.8% and 2.3% of EF's total assets in 2002 and 2003 respectively when the US Dollar then was weak. As observed, during the past 10 to 15 years, the number of years in which EF recorded foreign exchange gains and losses were more or less the same. Given that the foreign exchange market could be influenced by different factors including the policies of individual economies, it would be difficult to predict market changes precisely. The current investment strategies of EF were to diversify the currency mix in order to even out foreign exchange loss and gain in the medium to long term. CE/HKMA added that, compared to recent years, 2015 would be an even more difficult year for EF's investments having regard to a much "distorted" global financial/monetary environment making it difficult to apply usual or conventional investment strategies. Nevertheless, with an upward interest cycle setting in, the yield from bonds held by EF should improve in the near future. CE/HKMA and DCE(M)/HKMA further said that while HKMA would review EF's investment strategies and asset allocation (including the currency mix) each year and make suitable adjustment during the year as appropriate, the adjustment could not be substantial taking into account the high risks associated with the unpredictable economic and market conditions.

Property market

56. Mr CHAN Kam-lam observed that residential property prices continued to rise in spite of the demand management measures implemented by the Government in the past few years. He enquired whether HKMA would consider implementing further countercyclical macroprudential measures on property mortgage lending, with a view to reducing credit risks on the loan borrowers (in particular low-income borrowers) arising from the uncertain economic environment and the prospective interest rate rise. Mr CHAN stressed the importance to implement measures in a timely manner in view of the continuous uptrend of flat prices. Sharing similar concerns, the Chairman sought HKMA's advice for investors and home buyers.

57. CE/HKMA stressed that the current extremely low interest rate environment was unusual and would not last indefinitely. Unlike the uncertainties in previous years surrounding the upward adjustment of interest rate in the US and Hong Kong, it was likely that the US Federal Reserve would increase its interest rate in 2015, although the precise timing still remained uncertain. As such, consumers and homebuyers should stay vigilant of the potential risks of an interest rate rise on their personal or mortgage loans by taking into account their liquidity and loan repayment ability. While normalization of interest rates would impact on asset prices and the local

property market, further observation was needed to determine whether the up-cycle of the property market would continue. If necessary, HKMA would implement further countercyclical macroprudential measures to safeguard banking and financial stability.

Clearing and Settlement Systems (Amendment) Bill

58. Mr Kenneth LEUNG noted that the Clearing and Settlement Systems (Amendment) Bill 2015 ("the Bill") to be introduced into LegCo aimed to ensure protection of users' float maintained with SVF issuers and the security and soundness of the operations of SVF and RPS. He enquired about whether the regulatory requirements for non-device-based SVF (including facilities which stored value/data on network-based account such as cloud storage) would be distinguished from those for device-based SVF. He also asked if the regulatory requirements in respect of SVF issuers would be aligned with those for regulation of deposit-taking companies.

59. CE/HKMA and DCE(D)/HKMA explained that the current regulatory regime under the Banking Ordinance (Cap. 155) ("BO") applied to device-based multipurpose stored value products by making use of the existing framework for the regulation of deposit-taking business. Taking into account the purpose of BO in regulating the banking and deposit-taking businesses (and not SVF business per se) and in order to enhance users' protection, it was proposed that a new regulatory regime for RPSs and SVFs, including those which were non-device-based, be introduced under the Bill. The proposed regulatory requirements for both device-based and non-device-based SVFs would be on par. For instance, all licensed SVF issuers would be required to keep the float separate from the issuers' other funds. DCE(D)/HKMA added that if an SVF licensee undertook non-SVF business, the proposed regulatory regime would apply to his SVF business only. However, if non-SVF business would be operated through the SVF, the SVF licensee would be required to obtain HKMA's prior approval.

Difficulties encountered by money changers in opening bank accounts

60. Mrs Regina IP conveyed the concerns of money changers about difficulties encountered in opening accounts for their business with banks due to implementation of regulatory requirements under the anti-money laundering ("AML") and counter-terrorist financing ("CFT") regime. She enquired about the assistance that could be provided to the trade in this regard.

61. DCE(B)/HKMA said that there could be different reasons behind the banks' decisions not to accept applications for opening bank accounts for money changers. He observed that some international banks encountered

AML issues with their overseas operations and subsequently tightened their global internal requirements to refrain from dealings with operators of cash-handling businesses (e.g. money changers and remittance agents) so as to mitigate the AML risks faced by the banks. On the more general front, financial institutions including banks were required to observe enhanced international standards on AML/CFT controls, and had to put in place stringent customer due diligence measures in order to be in line with such enhanced standards. DCE(B)/HKMA said that HKMA had advised money changers with difficulties in opening bank accounts to discuss with the banks concerned and the relevant discussion/work was in progress.

Coin Collection Programme

62. Mr Kenneth LEUNG enquired whether HKMA would consider enhancing the Coin Collection Programme by adding more coin carts (in addition to the current two coin carts) to circulate in districts for collecting coins from the public, taking into account the good response and the relatively long waiting time in some estates/areas. Mr LEUNG also sought whether HKMA had any plan, in line with the international trend, to phase out the local coins in the next five to 10 years.

63. CE/HKMA was pleased to note that the Coin Collection Programme had been well-received. He pointed out that the arrangements of coin carts involved detailed planning and preparation (e.g. tendering procedures for procurement, design and retrofitting of carts for coin collection purpose and staff deployment). As the Programme would be implemented for two years on a pilot basis until September 2016, HKMA would conduct a review next year, including whether it was necessary to continue or enhance the Programme. As regards the phasing out of coinage, CE/HKMA said that while there was increasing usage of electronic payment for settlement, it could not replace coins having regard to the difficulties of some retail trades (e.g. newspaper stalls) to connect and operate electronic payment system at their business locations. Nevertheless, there might be room to reduce minting of new coins of some denominations having regard to their demand, while enhancing circulation of existing coins kept by end-users.

V Budget of the Securities and Futures Commission for the financial year 2015-2016

(LC Paper No. CB(1)445/14-15(05) — Administration's paper on "Securities and Futures Commission Budget for the Financial Year 2015-16"

LC Paper No. CB(1)445/14-15(06) — Background brief on the annual budgets of the Securities and Futures Commission prepared by the Legislative Council Secretariat)

Briefing by the Administration

64. At the invitation of the Chairman, the Chairman, SFC ("C/SFC") briefed members on SFC's proposed budget for 2015-2016 as set out in his speaking note tabled at the meeting.

(*Post-meeting note*: The speaking note was issued to members vide LC Paper No. CB(1)506/14-15(02) on 4 February 2015.)

Discussion

Operating deficit

65. Referring to SFC's projected budget deficit of $416.94 million in 2015-2016, Mr Ronny TONG enquired if SFC had plans to avert the deficit in the near future. He was concerned that although SFC could increase its levies when necessary, the timing of adjustment and hence the resultant levy income would hinge on the then prevailing market circumstances. Mr TONG suggested that SFC should consider other measures, such as imposing special levies on the northbound trading under S-HK SC, having regard to the additional regulatory and oversight responsibilities on SFC arising from implementation of S-HK SC and the relatively greater turnover in the northbound trading compared to the southbound trading.

66. C/SFC pointed out that levies on securities transactions and futures and options contracts was SFC's main source of income. Following past reductions in the levy rate, including the 10% reduction in 2014-2015, the levy income indeed could not fully cover SFC's annual expenditure. Unless there was substantial improvement in the market turnover in future, it was forecasted

that SFC would continue to incur annual operating deficit of some $400 million, and need to rely on its reserves to meet the funding gap. C/SFC added that SFC's substantial reserves were built up in 2007-2008 because of the extraordinary market situations then. Under the current assessment, in five years' time, SFC's reserves would be reduced to below twice of its estimated operating expenses for a financial year.

67. As regards the suggestion for SFC to impose levy on northbound trading under S-HK SC, the Chief Executive Officer, SFC ("CEO/SFC") said that SFC had no plan at this stage. He added that S-HK SC had been launched for only three months, and SFC had plans to conduct a comprehensive review six months after implementation of the pilot programme.

68. Mr NG Leung-sing expressed similar concern about depletion of SFC's reserves should it continue to record operating deficits in future years. He sought information on the changes in securities market turnover and related levy income before and after implementation of S-HK SC, as well as SFC's projected levy income for the coming years.

69. C/SFC said that the volume of southbound trading under S-HK SC did not have much impact on the Hong Kong securities market turnover after implementation of the pilot programme. The average daily market turnovers were $68 billion for October 2014 (before implementation of S-HK SC), and $79 billion, $105 billion and $90 billion for November and December 2014 and January 2015 respectively. As observed, there had been large fluctuations in the daily market turnover throughout the year. In 2014, the daily range was between $40 billion and $148 billion, and the average daily turnover was $74 billion. Having regard to great uncertainties in the securities market, it would be difficult for SFC to forecast the market turnover precisely and a conservative projection of daily turnover of $78 billion was therefore adopted for 2015-2016.

70. Mr Christopher CHEUNG opined that in order to reduce SFC's recurrent expenditure and operating deficit, SFC should consider relocating some of its non-location-bound back offices to districts of lower rentals. Mr CHAN Kam-lam considered it unhealthy for SFC to deploy its reserves to meet operating deficits in the long run. It was also inadvisable for SFC to cut its staff costs in view of the need for additional manpower to cope with SFC's increasing regulatory duties. Noting that SFC had budgeted $248.22 million in 2015-2016 for premises expenses, Mr CHAN opined that SFC should consider acquisition of its own office premises, with a view to saving rental expenses and achieving a balanced income and expenditure in the long run.

71. C/SFC agreed that a continued deficit was not healthy. He explained that the first exit option for the Cheung Kong Center premises would be in 2017. SFC would continue to explore all options, including whether to acquire office premises and/or whether to relocate all or part of its office premises to areas outside of Central.

72. In response to Mr NG Leung-sing's enquiry about the investment strategy for SFC's reserves, C/SFC advised that SFC had set up an Investment Committee tasked with duties including exploring measures to improve investment return for its reserves. The Committee had appointed four fund managers to handle investment of SFC's reserves. He stressed that SFC had an obligation to adopt conservative and cautious strategies for the investment of its reserves, including capping investment in equity funds at 15% of the overall investment portfolio and putting the remaining 85% on fixed-income investments (e.g. bonds).

Manpower plan

73. The Chairman observed that there had been a steady increase in SFC's headcounts in recent years and the total headcount had exceeded 800 in 2014-2015. He sought details on SFC's manpower increase in the past few years and whether it planned to expand further in the coming years. C/SFC said that the approved annual manpower requests from 2011-2012 to 2015-2016 were 61, 88, 58, 58 and 39 respectively, whereas the total headcounts in each of these five financial years were 648, 736, 794, 852 and 891 respectively. He pointed out that the request for 39 new posts in the proposed budget of 2015-2016 was the lowest in recent years. Unless there would be further expansion of SFC's regulatory ambit, the total headcount of 891 in 2015-2016 was considered sufficient to cope with the current workload. CEO/SFC supplemented that the substantial headcount increase by 52% over the past five years was absolutely necessary for strengthening the manpower required for proper regulation of the growing securities market. Compared to the growth in market capitalization by 129% and in the number of initial public offering applications by 116% in the same period, SFC's headcount increase had in fact lagged behind market expansion.

74. Mr Christopher CHEUNG expressed appreciation for SFC's efforts in maintaining market stability and assisting the development of the brokerage industry. In particular, he observed that SFC had been offering annual licensing fee holiday (including for one year effective on 1 April 2009, for two years effective on 1 April 2012, and for another two years from 1 April 2014) and set aside funding for enhancing training initiatives for intermediaries. Mr CHEUNG enquired about the need to provide special pay adjustment for high performing and experienced staff in 2015-2016, how was the proposed

provision of $17 million for this purpose worked out, the meaning of "high performing" staff and whether the special pay adjustment was a one-off or recurrent measure.

75. C/SFC said that the turnover rate of SFC's junior professionals was relatively higher, which was 12% to 13% compared to the overall staff turnover rate of 8%. The special pay adjustment, which was made in addition to the annual pay adjustment, was meant to retain high performing and experienced staff. He added that the special pay adjustment would only be implemented on positions or particular job areas with a relatively higher turnover rate taking into account the salaries offered by the private sector for the comparable positions. He pointed out that SFC would identify the high performing staff according to the established staff appraisal mechanism. C/SFC emphasized that SFC considered the special pay adjustment measure appropriate and worthwhile pursuing as otherwise SFC could incur higher cost for training replacement staff. Besides, the proposed provision of $17 million was only a budgeted sum and might not necessarily be exhausted. The exact amount of adjustment for the high performing staff members concerned would be decided by the executive directors of the relevant divisions.

Balance between market regulation and development

76. The Chairman expressed concern about the increasing difficult operating environment for various segments of the financial services industry as a result of enhanced regulation and increased compliance costs since the financial crisis and Lehman Brothers incident in 2008. He highlighted the need to strike a proper balance between market regulation and development, as well to nurture a level-playing field for small and large financial institutions.

77. C/SFC pointed out that SFC all along had been adopting a fair and just regulatory approach and following international standards and practices at large for all regulatees irrespective of their scale of operation. In fact, SFC attached much importance to ensuring proper regulation of large financial institutions having regard to the potentially greater systemic risks they would pose on the market and the investing public. CEO/SFC echoed that SFC placed increased emphasis on large financial institutions, noting that SFC had recently held a townhall meeting with large financial institutions to go through SFC's inspection findings. He added that SFC had cut down the time for authorization of funds to six months, and the average time taken was below that. CEO/SFC assured members that SFC would continue to work with the industry when taking forward regulatory initiatives.

Investor education

78. Referring to the proposed expenditure of $63.02 million for IEC in 2015-2016, Mr SIN Chung-kai enquired whether SFC would fund programmes to strengthen investor education in respect of S-HK SC, in particular to enhance investors' awareness of the risks associated with trading through the system, and the regulatory differences between Hong Kong and the Mainland in respect of listed entities.

79. C/SFC said that SFC attached importance to investor education in the implementation of S-HK SC, and had deployed substantial resources in this area. CEO/SFC said that IEC had launched investor education programmes in respect of S-HK SC through various channels (e.g. printed media, radio broadcasts and IEC's website), and also implemented related initiatives in collaboration with the Mainland authorities. These efforts would continue.

[At about 12:25 pm, the Chairman directed that the meeting be extended for 15 minutes to 12:45 pm.]

80. Mr SIN Chung-kai enquired about the measures/actions taken in past years on complaints relating to investment-linked assurance schemes ("ILAS"), and the division of regulatory and enforcement responsibilities between SFC and IIA for ILAS in future. Stressing the importance for the relevant regulators to apply consistent regulatory standards, Mr SIN suggested that the Office of the Commissioner of Insurance ("OCI"), SFC and HKMA should enter into a memorandum of understanding ("MOU") before passage of the Insurance Companies (Amendment) Bill 2014 ("IC(A) Bill") by LegCo to clarify their respective responsibilities and enhance cooperation in enforcement actions relating to ILAS.

81. CEO/SFC explained that under the current regulatory structure, point-of-sale bank, broker and agent insurance intermediaries were regulated and supervised by HKMA and OCI, whereas insurance companies issuing ILAS policies were regulated by OCI. ILAS products and their offering documents were authorized by SFC under a disclosure-based regime. CEO/SFC said that SFC had been working with HKMA and OCI to address ILAS-related issues. Concerted efforts of the three regulators had resulted in the recently revamped new product design guidelines and enhanced disclosure requirements for commission payments. The regulatory structure and division of responsibilities among the three regulators for ILAS might be further refined in future, and the three regulators met regularly to keep the matter under review. CEO/SFC added that the full effect of the new measures had yet to be seen. If ILAS products continued to comprise a large investment component (vis-à-vis the insurance element) and regulation of insurance

intermediaries at the point of sale continued to rest with the future IIA, it was likely that it would be necessary for SFC to collaborate with IIA to deal with issues relating to the investment component of ILAS.

82. The Deputy Secretary for Financial Services and the Treasury (Financial Services) 1 ("DS(FS)1") supplemented that the three regulators had been discussing improvements to regulation of ILAS regularly. The three regulators would continue to monitor closely the market situation after implementation of the enhanced regulatory measures, coordinate among themselves in respect of ILAS matters, and review the effectiveness of the regulatory control on ILAS with the establishment of IIA. The Administration would continue to facilitate the ILAS product revamp exercise which aimed to enhance, among others, product design, disclosure requirements and remuneration structure for ILAS products. She agreed that the future IIA could sign MOU with the two other regulators to enhance cooperation.

83. Referring to the existing measure whereby bank staff responsible for selling investment products were required to audio-record the process, Mr SIN Chung-kai enquired if similar requirements would be imposed on insurance intermediaries, with a view to enhancing protection for investors and facilitating investigation of complaints in future. The Chairman pointed out that for the sale of ILAS products not conducted at the insurance company's office and without audio recording of the selling process, ILAS issuers (i.e. insurance companies) were required to conduct post-sale calls for the ILAS buyers concerned to ensure they understood the important product features. Whereas the sales process would be audio-recorded if it was conducted by banks. He observed that the design of ILAS had been undergoing changes after promulgation of the product design guidelines. Looking forward, he considered that the regulation of ILAS should rest with the future IIA having regard to its supervisory role for insurance intermediaries, its expertise in insurance products and the already heavy workload of SFC.

84. At the request of Mr SIN Chung-kai, CEO/SFC agreed to provide information on the number of complaints it had received on ILAS in the past five years.

(*Post-meeting note*: SFC's written response was issued to members vide LC Paper No. CB(1)581/14-15(04) on 25 February 2015.)

Access to confidential information on Mainland incorporated entities

85. Mr Kenneth LEUNG conveyed the concerns of Hong Kong auditors about difficulties in accessing confidential information held by Mainland auditors in respect of Mainland incorporated entities when performing audits

for listed parent companies. He enquired whether SFC would consider entering into a protocol or MOU with CSRC to enable Hong Kong auditors when undertaking audits for Mainland entities to examine the audit working papers of Mainland auditors engaged by the Mainland entities concerned.

86. C/SFC reckoned that issues relating to access to working papers of Mainland auditors was a challenge for the Hong Kong audit profession, as well as SFC in the course of investigation and enforcement work, as in some cases such working papers might be regarded as state secrets. In fact, SFC was involved in a litigation with one of the Big Four accounting firms over such issues. Since last year, SFC had been engaging in detailed discussion with CSRC on the matter, and both parties were committed to seeking a solution. It was believed that the enhanced bilateral MOU signed between SFC and CSRC in respect of S-HK SC could serve an initial basis for tackling some of the issues. SFC would continue to take the opportunity of regular visits with CSRC's Chairman to discuss related issues.

87. Mr Kenneth LEUNG enquired whether signing of an MOU between SFC and CSRC regarding access to confidential information or other related measures would depend on the outcome of the Court's judgment on the litigation case mentioned above. CEO/SFC said that SFC would, in parallel with the ongoing litigation case, work with the Mainland authorities and the audit profession to seek more certainty about the types of information covered and the process.

Concluding remarks by the Administration

88. DS(FS)1 thanked members for their views and suggestions on SFC's proposed budget for 2015-2016, which the Administration would take into account when studying the budget in detail. While the Administration noted the need for SFC to increase its manpower to tie in with expansion in its regulatory ambit having regard to the latest international requirements on the securities market to meet the international standards, the Administration had been stressing to SFC the need to make better use of its existing resources and better management of its reserves, including possible procurement of office premises.

89. DS(FS)1 supplemented that while trading under S-HK SC would be subject to market conditions, a more holistic approach should be adopted in assessing the overall benefits of S-HK SC, including the increasing interest from institutional investors to set up pension funds or office headquarters in Hong Kong to make use of the direct investment opportunities offered by S-HK SC.

VI Any other business

90. There being no other business, the meeting ended at 12:37 pm.

Council Business Division 1
Legislative Council Secretariat
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