

立法會
Legislative Council

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Panel on Financial Affairs

**Minutes of meeting
held on Monday, 6 July 2015 at 9:00 am
in Conference Room 3 of the Legislative Council Complex**

Members present : Hon CHAN Kin-por, BBS, JP (Chairman)
Hon Christopher CHEUNG Wah-fung, SBS, JP
(Deputy Chairman)
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 Starry LEE Wai-king, 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 Steven HO Chun-yin, BBS
Hon IP Kwok-him, GBS, JP
Hon TANG Ka-piu, JP
Hon LEE Cheuk-yan

Members absent : Hon Mrs Regina IP LAU Suk-ye, GBS, JP
Hon Ronny TONG Ka-wah, SC

Public officers attending : Agenda item III

Mr Jackie LIU
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)5

Mr Henry CHENG, JP
Executive Director (Banking Supervision)
Hong Kong Monetary Authority

Mr Eric KAN
Senior Manager (Banking Supervision)
Hong Kong Monetary Authority

Agenda item IV

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

Miss Wendy CHUNG
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)3

Mr Darren McSHANE
Chief Regulation & Policy Officer and Executive Director
Mandatory Provident Fund Schemes Authority

Ms Gabriella YEE
Head (Policy Development and Research)
Mandatory Provident Fund Schemes Authority

Ms Stella YIU
Head (Investment Regulation)
Mandatory Provident Fund Schemes Authority

Agenda item V

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

Miss Wendy CHUNG
Principal Assistant Secretary for Financial Services
and the Treasury (Financial Services)³

Mr Darren McSHANE
Chief Regulation & Policy Officer and
Executive Director
Mandatory Provident Fund Schemes Authority

Ms Gabriella YEE
Head (Policy Development and Research)
Mandatory Provident Fund Schemes Authority

Agenda item VI

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

Ms Mable CHAN
Deputy Secretary for Financial Services and the
Treasury (Treasury)²

Mr Gary POON
Principal Assistant Secretary for Financial Services
and the Treasury (Treasury) (Revenue)

Mr CHIU Kwok-kit
Deputy Commissioner of Inland Revenue
(Technical)

Agenda item VII

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

Attendance by invitation : Agenda item III

Mr SHOU Fugang
Chief Executive
Bank of Communications Co., Ltd. Hong Kong
Branch

Ms Nancy CHAN
Alternate Chief Executive
Bank of Communications Co., Ltd. Hong Kong
Branch

Mr Alan LIU
Deputy Chief Executive
Bank of Communications Co., Ltd. Hong Kong
Branch

Ms Amy LO
Partner
Clifford Chance

Ms Virginia LEE
Partner
Clifford Chance

Mr James TAM
Partner
PricewaterhouseCoopers

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

Staff in attendance : Mr Hugo CHIU
Senior Council Secretary (1)4

Ms Sharon CHAN
Legislative Assistant (1)4

Action

I. Confirmation of minutes of meeting and matters arising

(LC Paper No. CB(1)962/14-15 — Minutes of the meeting on
13 April 2015)

The minutes of the meeting held on 13 April 2015 were confirmed.

II. Information papers issued since last meeting

(LC Paper No. CB(1)930/14-15(01) — 2014 Annual Report of the Hong Kong Mortgage Corporation Limited

LC Paper Nos. CB(1)955/14-15(01) and (02) — Letter dated 20 April 2015 from Hon Alice MAK on issues relating to licensed money lenders and the Administration's reply

LC Paper No. CB(1)999/14-15 — Report of the Panel on Financial Affairs for submission to the Legislative Council)

2. Members noted the information papers issued since the last regular meeting held on 1 June 2015.

III. Bank of Communications (Hong Kong) Limited (Merger) Bill

(LC Paper No. CB(1)1034/14-15(01) — Paper on "Bank of Communications (Hong Kong) Limited (Merger) Bill" provided by Hon NG Leung-sing's office)

Briefing on the Bill

3. At the invitation of the Chairman, Mr NG Leung-sing gave a brief introduction on the Bank of Communications (Hong Kong) Limited (Merger) Bill ("the Bill"). He explained that the purpose of the Bill, which would be introduced into LegCo as a private member's bill, was to provide for the transfer of the retail banking business and private banking business of Bank of Communications Co., Ltd. ("Bank of Communications") currently operating through a branch in Hong Kong ("Bank of Communications Hong Kong Branch") to a wholly-owned subsidiary within the Bank of Communications group of companies. The subsidiary had been incorporated in Hong Kong and was applying for a bank licence. The new subsidiary would be renamed Bank of Communications (Hong Kong) Limited ("Bank of Communications (Hong Kong)") upon the approval of the Hong Kong Monetary Authority ("HKMA"), and would become an independent licensed bank with a board of directors of its

own. Its business operations and capital requirements would be subject to the regulatory requirements of the Banking Ordinance ("BO") (Cap. 155) applicable to locally-incorporated authorized institutions. The provisions of the Bill were similar to those of the bank merger ordinances previously passed by LegCo.

4. Upon the Chairman's invitation, Mr SHOU Fugang, Chief Executive, Bank of Communications Hong Kong Branch briefed members on the Bill. He highlighted the following points:

- (a) The Bill formed part of Bank of Communications' strategy to continue building on a strong foundation in Hong Kong by expanding and intensifying its business and product offerings. The proposed merger would enable Bank of Communications to follow the development trend in the industry and further affirm its long-term service commitment to customers, employees as well as members of the public in Hong Kong;
- (b) Bank of Communications (Hong Kong) would be established as a licensed bank. Its corporate governance structure would consist of the board of directors, board committees and senior management in accordance with the requirements under BO. It would be regulated by HKMA, and its operation would become more transparent after the merger. Moreover, the merger signified a clearer and more focused separation in the servicing of relevant customer groups by Bank of Communications (Hong Kong) and Bank of Communications Hong Kong Branch, enhancing the quality of the products and services; and
- (c) It was intended that the relevant employees would be transferred from Bank of Communications Hong Kong Branch to Bank of Communications (Hong Kong), and the terms of their contracts of employment would be in line with those with Bank of Communications Hong Kong Branch. The employees would not suffer any losses in respect of accrued benefits, including annual leave and long service leave. The continuity of their employment would not be interrupted as a result of the merger.

(Post-meeting note: The speeches delivered by Mr NG Leung-sing and Mr SHOU Fugang (LC Paper Nos. CB(1)1076/14-15(01) and CB(1)1076/14-15(02)) were issued to members vide Lotus Notes e-mail on 7 July 2015.)

Discussion

5. Mr Kenneth LEUNG declared that he was an employee of Clifford Chance, the legal advisor of Bank of Communications Hong Kong Branch, and that he would not vote on this agenda item as he might have indirect pecuniary interest relating to the item.

The proposed merger and the draft Bill

6. Mr Christopher CHEUNG noted that, after the proposed subsidiarization, the retail and private banking businesses would be carried out by Bank of Communications (Hong Kong), whereas the corporate banking business and other businesses would remain in Bank of Communications Hong Kong Branch. He asked how the proposed subsidiarization would benefit the banks' development in future and protect the customer interests. He further enquired if there was any plan to list Bank of Communications (Hong Kong) on the Stock Exchange of Hong Kong.

7. Mr SHOU advised that the proposed subsidiarization was part of Bank of Communications' strategy to continue building on its strong foundation in Hong Kong by expanding and intensifying the retail and private banking businesses, thereby responding to the growing demand for a variety of banking and financial services. The subsidiarization demonstrated the bank's long-term commitment to Hong Kong and its customers, employees and business partners. He pointed out that the local subsidiary would be a licensed bank incorporated in Hong Kong with a corporate governance structure consisting mainly of the board of directors, board committees and senior management in accordance with requirements under BO. The operation of Bank of Communications (Hong Kong) would be more transparent, while the governance would be increasingly localised to interact with customers, employees and other business partners, thus strengthening the internal governance of the bank.

8. In response to Mr Christopher CHEUNG's enquiry on clause 4 of the draft Bill, Ms Virginia LEE, Partner of Clifford Chance, explained that the "property and liabilities" which formed part of the undertakings of Bank of Communications Hong Kong Branch that would be transferred and vested in Bank of Communications (Hong Kong) consisted primarily of the customers' deposits with Bank of Communications Hong Kong Branch and the duties and liabilities under the relevant contracts entered into between the bank and its customers.

9. Mr James TO pointed out that, while existing customers of Bank of Communications Hong Kong Branch were clients of a branch of Bank of Communications which was a nationwide state-owned commercial bank well established in China with a huge capital size, the new Bank of Communications (Hong Kong) would only be a subsidiary of the Bank of Communications established in Hong Kong with its capital size and financial soundness yet to be ascertained. He was concerned whether the proposed subsidiarization would have an impact on, and provide sufficient protection for, existing customers of Bank of Communications Hong Kong Branch, in particular in respect of those with long-term contracts with the bank. Mr TO further enquired about the estimated capital to be injected by Bank of Communications into Bank of Communications (Hong Kong) in ensuring its financial viability.

10. Mr SHOU said that the capital requirement of Bank of Communications (Hong Kong) would be subject to the regulatory requirements of BO. He added that all relevant contracts and agreements (including long-term contracts) made with, given to or addressed to Bank of Communications Hong Kong Branch with respect to the retail banking and private banking businesses would be transferred to Bank of Communications (Hong Kong) upon the subsidiarization and the rights and liabilities under those contracts and agreements would be adequately protected in accordance with law.

Bad debts and non-performing loans

11. Mr Dennis KWOK noted that the volume of non-performing loans of Bank of Communications had increased by 17% recently and enquired about the alleged difference between the relevant announced figures and the actual volume. He asked if bad debts and non-performing loans of a bank were among the criteria considered by HKMA in granting a bank licence, and whether HKMA had assessed the potential impact of bad debts and non-performing loans of banks incorporated in the Mainland on Hong Kong's banking stability if those problems were to keep exacerbating in the Mainland.

12. Executive Director (Banking Supervision), Hong Kong Monetary Authority ("ED/HKMA") said that HKMA had all along been monitoring the situation of bad debts and non-performing loans of Mainland banks and had been communicating closely with the China Banking Regulatory Commission in this regard. He added that the ratios of bad debts and non-performing loans of local and Mainland banks in Hong Kong were maintained at a healthy level and were not envisaged to have a significant impact on the financial stability of Hong Kong. Results of stress tests conducted by HKMA also indicated the resilience of the Hong Kong banking system in withstanding an increasing level of bad debts and non-performing loans in the Mainland. He further said

that the proposed merger would strengthen the internal governance of Bank of Communications (Hong Kong) as the bank would have an independent board of directors and its business operations and capital requirements would be subject to the regulatory requirements of BO.

13. On the financial soundness of Bank of Communications Hong Kong Branch, Mr SHOU said that the bank had been operating in Hong Kong for more than 80 years and its capital standards were among the highest within the banking industry in Hong Kong. He emphasized that the newly established Bank of Communications (Hong Kong) would be a wholly-owned subsidiary of Bank of Communications in Hong Kong subject to the supervision of HKMA. The corporate governance structure, risk management and internal control systems of Bank of Communications (Hong Kong) would have to comply with Hong Kong's supervisory and regulatory standards. With a more transparent mode of operation and stringent controls under Hong Kong's regulatory regime, he believed that customers' assets and interests would be better protected after the subsidiarization.

Impact on employees

14. Mr WONG Kwok-hing said that he was a depositor of Bank of Communications Hong Kong Branch and indicated support for the proposed merger. He expressed concern about the possible impacts of the proposed transfer on existing employees of Bank of Communications Hong Kong Branch, and enquired if the merger would fully recognize the years of services of existing employees and preserve their rights and accrued benefits under their employment contracts, and whether their promotion prospects would be affected.

15. Mr SHOU responded that the bank had briefed and explained to employees the details of the subsidiarization, including the staff transfer arrangements, on several occasions. Employees had not raised particular objection. The terms and conditions of employment contracts with Bank of Communications (Hong Kong) would be in line with those with Bank of Communications Hong Kong Branch, with the accrued benefits of existing employees, including their years of services, to be fully recognized. He said that the promotion prospects of existing employees would not be adversely affected by the subsidiarization. Following the transfer of business, Bank of Communications Hong Kong Branch and Bank of Communications (Hong Kong) would continue to expand their businesses, and the relevant employees were expected to have a better career prospect after the subsidiarization.

16. Mr James TO shared the concern about the impact of the proposed subsidiarization on existing staff members of Bank of Communications Hong

Kong Branch, in particular the potential difficulties in classifying the job duties of the supporting staff into retail and private banking businesses, or corporate and other banking businesses in making staff transfer arrangements. He also expressed concern about the scale of operation and capital size of the newly established Bank of Communications (Hong Kong) relative to that of Bank of Communications. Given that members could form a bills committee to scrutinize the private member's bill, the Chairman said that further details and technical issues raised by members could be followed up by the relevant bills committee.

Bank mergers in Hong Kong

17. In reply to Mr SIN Chung-kai's enquiry about any precedent case similar to the subject Bill, ED/HKMA advised that the transfer of the retail banking business of Citibank, Hong Kong Branch ("Citibank (HKB)") to Citibank (Hong Kong) Limited ("Citibank (HKL)") was also effected by way of establishing a new wholly-owned subsidiary in Hong Kong through a private member's bill. After that merger, the retail banking business of Citibank (HKB) was transferred to Citibank (HKL), which was a licensed bank incorporated in Hong Kong and authorized under BO; whereas Citibank (HKB) continued to carry out non-retail banking business in the same manner as before.

18. Mr Albert HO enquired about the existing legislative framework governing bank mergers in Hong Kong and the reasons for introducing a private member's bill into LegCo to effect a bank merger in lieu of seeking approval from the court on the transfer of banking businesses between the entities as in the case of merger and reorganization of companies. He was of the view that the power to approve individual cases of merger should be vested in the court.

19. In response, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) 5 said that it was the Government's policy to support consolidation in the banking sector in Hong Kong under the condition that those activities would not undermine the stability and the effective working of the banking system, and that the interests of the depositors and any concerned third parties would be properly protected. Since 1997, more than ten private member's bills in relation to bank merger had been passed by LegCo. He added that, in considering whether a generic legislation governing bank merger and reorganization in Hong Kong should be introduced, the Government had conducted a study in 2006 to review the present framework for effecting bank merger by means of a private member's bill and examine the framework adopted by overseas jurisdictions in facilitating such bank mergers. The study revealed that there was no common international

practice in effecting transfer of banking business, and that the introduction of private member's bills had been an effective way to take forward bank mergers. The views of the Judiciary were also sought then on whether the court should be designated as the sanctioning authority for the transfer of bank business. The Judiciary considered it not appropriate for the court to take on such a role, on the grounds that the transfer would involve a wide range of public policy issues falling outside the purview of the Judiciary, and the arrangements of effecting bank merger by private legislation in the status quo had worked well. Hence, the Government considered it unnecessary to introduce any fundamental changes to the existing system.

Conclusion

20. Concluding the discussion, the Chairman informed members that Mr NG Leung-sing planned to introduce the Bill into LegCo by the end of 2015.

IV. Consultation results and the way forward for Mandatory Provident Fund ("MPF") Core Fund

(LC Paper No. CB(1)1034/14-15(02) — Administration's paper on "Legislative Proposals for the MPF 'Core Fund'"

LC Paper No. CB(1)1034/14-15(03) — Background brief on the MPF Core Fund prepared by the Legislative Council Secretariat)

Briefing by the Administration

21. At the invitation of the Chairman and with the aid of a powerpoint presentation, the Chief Regulation and Policy Officer and Executive Director, Mandatory Provident Fund Schemes Authority ("CRO/MPFA") briefed members on the results of the public consultation and legislative proposals for introducing the Mandatory Provident Fund ("MPF") Core Fund. Under the legislative proposals, the Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("MPFSO") would be amended to make it a statutory requirement for an approved trustee to provide a standardized Default Investment Strategy ("DIS") (formerly called the "Core Fund") under each MPF scheme, and to invest the benefits of scheme members who had not given a specific investment instruction in accordance with DIS ("DIS members"). Assets under DIS would be invested in a globally diversified manner and the investment risk exposure of DIS members would be adjusted in accordance with the individual member's

age, i.e. the de-risking mechanism. The trustee would be required to utilize two constituent funds ("CFs") under an MPF scheme for DIS investments, namely, a higher risk mixed asset fund, i.e. the Core Accumulation Fund, and a lower risk mixed asset fund, i.e. the Age 65+ Fund. The trustee would be required to invest the benefits of a DIS member who was between the age of 18 to 50 in the Core Accumulation Fund. When the DIS member reached the age of 50, the trustee would be required to adjust annually the benefits of the member to progressively reduce the allocation to the Core Accumulation Fund while progressively increase the allocation to the Age 65+ Fund. It was proposed that the total management fees (which would cover fees paid or payable to, for example, trustee, administrator, investment manager and sponsor, as well as similar fees paid in respect of underlying investment funds) of each of the Core Accumulation Fund and the Age 65+ Fund of each MPF scheme should not exceed 0.75% of the assets under management ("AUM") per annum. The Government aimed to finalize the relevant Bill for introduction into the Legislative Council ("LegCo") by end of 2015 with a view to introducing DIS in 2016.

(Post-meeting note: The notes of the powerpoint presentation (LC Paper No. CB(1)1069/14-15(01)) were issued to members vide Lotus Notes e-mail on 7 July 2015.)

Discussion

Fee control for the Default Investment Strategy

22. Mr WONG Kwok-hing noted that with the launch of DIS, the total management fees of DIS CFs should not be higher than 0.75% of AUM per annum, and the Mandatory Provident Fund Schemes Authority ("MPFA") also envisaged that the fees level would be further reduced in the long run. He enquired about the expected timeframe for reduction of the fees level and considered that the relevant Bill should contain provisions for MPFA to review the management fees of DIS CFs on an annual or a bi-annual basis so as to keep the momentum in driving down MPF fees. While supporting the proposal of DIS, Mr Christopher CHEUNG considered that the proposed fees level at 0.75% of AUM per annum was on the high side and asked if there would be room to reduce the level. He also remarked that the investment performance of many MPF funds was not commensurate with their fees.

23. Mr WONG Ting-kwong declared that he was the Chairman of MPF Schemes Advisory Committee. He highlighted that the relevant Bill should include provisions to prevent trustees from circumventing the proposed fee control mechanism. He sought details of the relation between the total management fees and the Fund Expense Ratio ("FER") of DIS CFs, and

enquired about the actual expense ratio to be borne by DIS members. Mr WONG Kwok-hing shared the view and stressed the need to prevent trustees from employing alternative fee charging practices. He suggested that the relevant Bill should state clearly that the total management fees should be inclusive of all fees.

24. CRO/MPFA said that MPFA considered that the proposed fee ceiling of 0.75% of AUM per annum for a DIS CF was a fair starting point. While it would be difficult to provide a concrete timetable on further fee reduction, MPFA would review the issue having regard to the actual operation of DIS.

25. Deputy Secretary for Financial Services and the Treasury (Financial Services)2 ("DS(FS)2") supplemented that the relevant Bill would include a mechanism for adjusting the ceiling for management fees of DIS CFs. He assured members that there would be provisions in the Bill to prevent trustees from circumventing the fee control mechanism. CRO/MPFA added that trustees had to seek the prior approval of MPFA on changes in governing rules including those changes in fees, and MPFA would examine each application carefully.

26. As regards FER, DS(FS)2 explained that it was a ratio that measured the total expense impact as a percentage of fund size and included the total management fees. As FER could only be compiled after the audited financial statements of the trustees were available, it would be impossible to set a ceiling on FER in the legislation. Nevertheless, trustees were required by MPFA to calculate and release data on FER for each CF. This would enhance transparency in the operation of CFs and allow for identification of any CF that had total expenses disproportionate to fund size.

Operation of the Default Investment Strategy

27. While conveying the support of the Democratic Alliance for the Betterment and Progress of Hong Kong ("DAB") for the proposal on DIS to address concern about high fees of MPF schemes, Ms Starry LEE expressed concern that the proposal could not tackle the problem of poor investment performance of MPF schemes. She asked if the Administration would study DAB's suggestion for the Hong Kong Monetary Authority ("HKMA") to take up the role of a public trustee to operate DIS CFs so that DIS members would be provided with investment options with returns comparable to that of the Exchange Fund or options that could beat inflation. Mr WONG Kwok-hing echoed the views and considered that a public trustee could help lower the operating costs of MPF schemes and reduce management fees.

28. DS(FS)2 responded that the suggestion of entrusting a public trustee or HKMA to operate DIS CFs would require the establishment of a new operating

system and replication of the administrative tasks currently handled by private trustees, which in turn would involve a long period of preparation and development. In order to introduce DIS in a timely manner and given that the MPF system was a privately-managed system, the Government considered it appropriate for the market to operate DIS CFs. He pointed out that DIS CFs were similar to some existing mixed asset funds under MPF schemes. The average annualized return of such funds (after fee deduction) for the past five years was around 5.5%.

29. Mr SIN Chung-kai relayed the support of the Democratic Party for the proposal. He enquired whether the Government and MPFA had assessed the operation of the de-risking mechanism through modeling techniques, and studied similar mechanisms adopted in the retirement schemes of other jurisdictions. Pointing out that the average retirement age in Hong Kong might change in future, Mr SIN enquired whether the relevant Bill would include provisions on the review and adjustment of the de-risking mechanism to cater for future changes in the retirement age. Mr James TIEN also suggested that the Government and MPFA should explore the feasibility of using other criteria (like the amount of accrued benefits in MPF schemes) for determining the on-set of the de-risking mechanism.

30. CRO/MPFA responded that MPFA had engaged the Organisation of Economic Co-operation and Development ("OECD") to conduct modeling on the de-risking strategy using both global and local data and concluded that the strategy was effective. While different jurisdictions used different commencement ages for the de-risking mechanism in their retirement schemes, MPFA had decided to adopt the proposed commencement age of 50 based both on the results of the OECD modeling and discussion with the industry. He explained that the proposed de-risking mechanism had been worked out with reference to current parameters. The relevant Bill would contain provisions to cater for changes to the de-risking mechanism.

31. Responding to Mr Kenneth LEUNG's enquiries about the operation of DIS and MPFA's considerations in deciding the number of CFs for DIS, CRO/MPFA advised that after implementation of DIS, the switching rights of MPF scheme members would be preserved and they could switch in and out of DIS CFs and other CFs freely. CRO/MPFA remarked that the standardized disclosure materials to be issued by the trustees would however point out that such switching in and out of funds might not be a good strategy as the design of DIS, which was a risk reduction strategy, was based on a 40-year investment horizon and hence DIS was designed to operate and accrue benefits conducive to retirement savings in the long run. Besides, scheme members could give instructions to the trustee specifying the proportion of their accrued benefits to be invested in the Core Accumulation Fund and the Age 65+ Fund and also

other CFs under the scheme instead of following the proposed allocations specified in the de-risking mechanism which was only applicable to DIS scheme members. In that case, the proposed automatic de-risking mechanism would not apply to the allocation to the Core Accumulation Fund and the Age 65+ Fund. CRO/MPFA added that while a scheme member might not be able to allocate part of his/her accrued benefits to DIS and the rest to other CFs of an MPF scheme initially due to system limitations of trustees, MPFA would continue to discuss with the industry on the feasibility of relaxing this restriction. He remarked that two CFs were proposed for implementing the DIS as this could achieve the investment principles of balancing long-term risks and returns in a manner appropriate for retirement savings on one hand and keep the scheme simple on the other.

32. Ms Starry LEE opined that the Administration and MPFA should consider adopting another name for DIS CFs, such as "限制管理費基金", to better reflect the purpose of the funds which was to address the problem of high management fees of MPF schemes, and facilitate understanding of the public on the benefits of the funds. DS(FS)2 took note of Ms LEE's views. He said that the term "DIS" would be used in the relevant Bill and the Government and MPFA would step up public education and publicity on the DIS CFs.

Investments under the Default Investment Strategy

33. Mr Christopher CHEUNG enquired whether CFs with guaranteed returns would be introduced in future given that the capital preservation funds of some MPF schemes failed to fulfill their investment objectives. Mr CHAN Kam-lam suggested that investment options incurring low fees, such as bank deposits, should be allowed under DIS.

34. DS(FS)2 reiterated that MPF was a privately-managed system and it would be difficult if not inappropriate to require trustees to provide funds with guaranteed returns. Based on the findings of OECD's consultancy study, the investment strategies of DIS was consistent with those adopted by the retirement schemes of other jurisdictions as a default fund.

35. Mr CHAN Kam-lam remarked that there had been criticisms about the MPF system since its launch, including restricted usage of the accrued benefits and low transparency in the operation of trustees. He called on the Government and MPFA to consider relaxing the use of accrued benefits by scheme members for mortgage payments and medical expenses.

36. DS(FS)2 said that the Government was aware that there was room for improvement in the MPF system which had been launched for just 15 years. He advised that with the enactment of the Mandatory Provident Fund Schemes

(Amendment) Ordinance 2015, MPF scheme members were provided with enhanced withdrawal flexibility through the option of phased withdrawal upon scheme members' retirement or early retirement. Scheme members might also withdraw accrued benefits on grounds of incapacity or terminal illness. As regards the suggestion of providing more withdrawal grounds, DS(FS)2 remarked that while Singapore allowed citizens to utilize their contributions to the Central Provident Fund ("CPF") for uses other than retirement needs, the contribution rate of Singapore's CPF, which was more than 30% of the monthly salary, was much higher than that of the MPF system in Hong Kong.

Conclusion

37. Concluding the discussion, the Chairman said that Panel members had no objection to the Administration's plan to introduce the relevant Bill into LegCo by the end of 2015.

V. Consultation Results and Way Forward for the Review of the Adjustment Mechanism for the Minimum and Maximum Levels of Relevant Income for MPF Mandatory Contributions

(LC Paper No. CB(1)1034/14-15(04) — Administration's paper on "Review of the Adjustment Mechanism for the Minimum and Maximum Levels of Relevant Income for MPF Mandatory Contributions"

LC Paper No. CB(1)1034/14-15(05) — Updated background brief on the adjustment mechanism for the minimum and maximum levels of relevant income for MPF mandatory contributions prepared by the Legislative Council Secretariat)

Briefing by the Administration

38. At the invitation of the Chairman and with the aid of a powerpoint presentation, CRO/MPFA briefed members on the results of the public

consultation on the review of the adjustment mechanism for the minimum and maximum levels of relevant income ("Min RI" and "Max RI") for MPF mandatory contributions. He said that in view of the lack of general support for and diverse views on the proposed automatic adjustment mechanism ("the Proposal"), MPFA had recommended not to pursue, in whole or in part, the Proposal for the time being, and to continue reviewing the Min RI and Max RI levels under the existing statutory adjustment mechanism in accordance with section 10A of MPFSO. The Government had agreed with MPFA's recommendations.

(Post-meeting note: The notes of the powerpoint presentation (LC Paper No. CB(1)1069/14-15(02)) were issued to members vide Lotus Notes e-mail on 7 July 2015.)

Discussion

Decision of not pursuing the proposed automatic adjustment mechanism

39. Pointing out that labour unions of different political stances had indicated support for the Proposal, Mr WONG Kwok-hing expressed strong dissatisfaction towards the Government's decision of not pursuing the Proposal. Mr WONG noted that among the 35 075 submissions received in response to the consultation, some 34 000 which expressed negative comments to the Proposal were received on the last two days of the consultation period. He queried whether the Administration had given more weight to these 34 000 submissions, and why LegCo had not held public hearings on the subject. He further questioned whether the Administration had specified clearly during the consultation exercise that it would not pursue the Proposal if there were a large number of opposing submissions. He urged that the Government should conduct an in-depth analysis on the views collected during the consultation exercise and hold a new round of public consultation to resolve the differences. Given that the Statutory Minimum Wage ("SMW") had been raised from \$30 to \$32.5 per hour with effect from 1 May 2015, Mr WONG expressed concern that if the Min RI level was not adjusted upwards in time, the interests of low-income employees would be adversely affected.

40. Mr TANG Ka-piu supported the Proposal and considered that the Government's decision would only benefit employers of large enterprises. He commented that a large number of respondents were opposed to the Proposal because they were dissatisfied with the two major problems of the MPF system, namely, high management fees and the arrangement of allowing employers to use their contributions to MPF schemes to offset their severance payments and long service payments to employees.

41. Mr LEE Cheuk-yan expressed support for the Proposal. He concurred that opposing views on the Proposal stemmed from the two major problems of the MPF system, and called on the Administration to tackle the two problems. He also considered that the employees would support an automatic adjustment mechanism for the Min RI level, which might reduce their MPF contributions.

42. Mr James TIEN pointed out that employers in general did not support the Proposal. Moreover, the Proposal could not address the problem of low investment returns of MPF schemes. Given the global and local environment with slow economic growth and low inflation and interest rates, he was of the view that it would be inappropriate to conduct review of the Min and Max RI levels in a more frequent interval. He remarked that whether to pursue the proposed automatic adjustment mechanism was a trade-off between certainty and flexibility. He supported the Government's decision not to pursue the Proposal at the moment.

43. DS(FS)2 pointed out that the Government and MPFA had received 34 985 submissions from members of the public on the last two days of the consultation period when there were misleading messages spreading on social media that the Proposal would lead to continual upward adjustment of the Max RI level and produce Min and Max RI level adjustment results that would not require scrutiny by LegCo. He clarified that the Government and MPFA had not made the decision merely based on the number of supporting/opposing submissions received, nor had they made the decision favouring employers or employees. He said that it was observed from the responses to the consultation that there were diverse views on and a lack of general support for the Proposal. The Government had made the decision after careful and in-depth analysis of the responses received. He agreed with members' view that whether to pursue the Proposal was a trade-off between certainty and flexibility. As regards the review of the Min and Max RI levels, DS(FS)2 stressed that MPFA would conduct the review in accordance with the existing statutory adjustment mechanism. The Government was mindful of the difficulties encountered by the low-income employees and would adjust the Min RI level as necessary. In determining the Min RI level, the Government had to strike a proper balance between relieving the financial burden on low-income employees and addressing their retirement needs. DS(FS)2 also remarked that the policy objectives of SMW and the Min RI level were different and pegging them with each other would be inappropriate.

Need for a new round of consultation and the next review on the existing Min and Max RI levels

44. While appreciating the difficulty for the Government and MPFA to conduct another consultation on the subject in the near future, Mr SIN

Chung-kai considered that the Government should not give up pursuing the Proposal. He called on the Government and MPFA to consider launching a new round of consultation on the Proposal as early as possible in the next term of LegCo, and continue engaging the public and addressing their concerns in the meantime.

45. Mr LEE Cheuk-yan suggested that the Government should consider implementing separate automatic adjustment mechanisms for the Min and Max RI levels, and strengthen publicity on the benefits of an automatic adjustment mechanism for the Min RI level in lowering the mandatory MPF contributions of low-income earners. On the review of the current Min RI level, Mr LEE called on MPFA to conduct the review annually, and urged the Government to immediately introduce the relevant legislative amendments to raise the Min RI level. He envisaged that the public would not oppose the legislative amendments which could reduce their MPF contributions. He said that he would contemplate introducing a private member's Bill if the Government did not consider his suggestion.

46. Mr TANG Ka-piu enquired when MPFA would conduct its next review of the Min and Max RI levels in accordance with the existing statutory adjustment mechanism. He urged the Government and MPFA to conduct the relevant review promptly given that SMW had been increased to \$32.5 per hour with effect from 1 May 2015.

47. DS(FS)2 responded that the MPF system had been launched for 15 years only and the Government would continue to review the system in identifying room for improvement. Moreover, MPFA and the Government would step up efforts to educate the public on the Min and Max RI levels and related issues, such as different impacts of the adjustment on employees. MPFA and the Government would not rule out conducting a new round of consultation when it was necessary and appropriate. DS(FS)2 also remarked that a number of improvement measures had been introduced for the MPF system and were proven effective. For instance, it was observed that FER of most funds under MPF schemes was declining. As regards the timing for the next review of the Min and Max RI levels, DS(FS)2 responded that under the existing statutory adjustment mechanism, MPFA must conduct a review of the two levels not less than once in every four years. CRO/MPFA added that it was envisaged that factors relating to the recent adjustment in SMW would be taken into account during the statutory review of the Min and Max RI levels.

48. On the suggestion of implementing different adjustment mechanisms for the Min and Max RI levels, CRO/MPFA advised that the purpose of the consultation was to review the existing adjustment mechanism of the Min and Max RI levels. MPFA had examined the suggestion, and concluded that it was not advisable as the MPF contribution framework should be considered in a

holistic manner. If separate adjustment mechanisms were to be introduced, it was envisaged that the Min RI level would increase continuously while the Max RI level would remain unchanged, resulting in a contracting contribution band. The long-term retirement protection benefits of the MPF system might subsequently be compromised.

Motion

49. The Chairman informed members that Mr WONG Kwok-hing had put forward a proposed motion on this item, the wordings of which were as follows –

"促請政府延長檢討強積金強制性供款最低及最高有關之水平調整機制的諮詢。"

(Translation)

"The Administration was urged to extend the public consultation on the review of the adjustment mechanism for the minimum and maximum levels of relevant income for Mandatory Provident Fund mandatory contributions."

50. The Chairman considered that Mr WONG Kwok-hing's proposed motion was directly related to the agenda item. Members had no objection to the Panel dealing with the motion. Upon the Chairman's invitation, Mr WONG explained that his motion aimed to urge the Government and MPFA to extend the consultation period for the Proposal. He pointed out that some labour unions which supported the Proposal might not have responded to the consultation as they envisaged that there would be overwhelming support for the Proposal and did not expect that the Government would shelve the Proposal upon receiving a large number of opposing submissions. Should the consultation period be extended, labour unions would send in submissions expressing support for the Proposal, and LegCo would have the opportunity to hold public hearings on the subject.

51. In response to Mr CHAN Kam-lam's enquiries, DS(FS)2 advised that the Government and MPFA consulted the Panel on the Proposal at the latter's meeting on 2 March 2015. Diverse views were expressed by members at the meeting.

52. Mr Abraham SHEK declared that he was a Non-executive Director of the Management Board of MPFA.

53. The Chairman put Mr WONG Kwok-hing's motion to vote. Of the members present, two members voted for the motion and two members voted against it. The Chairman declared that the motion was negated. Mr WONG Kwok-hing remarked that he would continue to pursue the matter in the next legislative session.

VI. Automatic Exchange of Financial Account Information in Tax Matters

(LC Paper No. CB(1)1034/14-15(06) — Administration's paper on "Automatic Exchange of Financial Account Information in Tax Matters"

LC Paper No. CB(1)1034/14-15(07) — Updated background brief on the automatic exchange of financial account information in tax matters prepared by the Legislative Council Secretariat)

Briefing by the Administration

54. At the invitation of the Chairman and with the aid of a powerpoint presentation, the Permanent Secretary for Financial Services and the Treasury (Treasury) ("PS(Tsy)") briefed members on the proposed policy and legal framework on automatic exchange of financial account information in tax matters ("AEOI"), the major views gathered during the consultation on the subject conducted from 25 April to 30 June 2015 and the relevant implementation timetable. She pointed out that the Government had indicated to the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") of the Organization for Economic Cooperation and Development ("OECD") Hong Kong's commitment to commence the first automatic information exchange by the end of 2018 on the condition that the necessary legislation could be put in place by 2017.

(Post-meeting note: The notes of the powerpoint presentation (LC Paper No. CB(1)1069/14-15(03)) were issued to members vide Lotus Notes e-mail on 7 July 2015.)

Discussion

Legislative and implementation timetable

55. Mr Kenneth LEUNG noted that the Government's target was to introduce the amendment bill on AEOI into LegCo in early 2016 with a view to enacting the legislation before end 2016 in order to facilitate commencement of the first automatic information exchange by the end of 2018. Given that the implementation of AEOI would have significant and far-reaching impacts on financial institutions ("FIs"), it was expected that LegCo would require relatively longer time to scrutinize the amendment bill. Expressing concern about the tight timetable, Mr LEUNG enquired if the Government could seek extension from the Global Forum on the commencement of AEOI in Hong Kong in the event that the amendment bill could not be enacted before end 2016, and the possible impacts on Hong Kong if it could not meet the commitment of implementing the first automatic information exchange by the end of 2018. He further enquired about complex issues encountered by the Administration in developing the legislative proposals.

56. Mr SIN Chung-kai, Mr CHAN Kam-lam and Mr NG Leung-sing shared the concern about the tight legislative timetable. Mr SIN urged that the Administration should introduce the amendment bill into LegCo soonest possible and preferably by end of 2015 so as to allow sufficient time for its scrutiny. Mr CHAN called on the Administration to continue engaging LegCo Members and stakeholders on the legislative proposals in preparing the amendment bill which would facilitate examination of the bill in an effective and timely manner. Mr NG further suggested that the Administration should consider setting up a working group with representatives from the financial services industry and the relevant stakeholders in formulating the detailed legislative proposals and working out the reporting procedures.

57. PS(Tsy) responded that commencing the first automatic information exchange by the end of 2018 was indeed the latest timeline allowable by the Global Forum for AEOI implementation, and most Global Forum member jurisdictions had indeed committed to implement the new standard by the end of 2017. She added that the Global Forum would conduct a peer review on member jurisdictions regarding AEOI implementation from 2017 onwards and committed jurisdictions were expected to go through review on aspects including effectiveness of their legal framework in and progress of implementing AEOI. It would be crucial for Hong Kong to pass the peer review to avoid being labelled as a "non-compliant" or "non-cooperative" tax jurisdiction, which could seriously undermine Hong Kong's position as an international financial centre.

58. As regards the issues involved in the legislative proposals, PS(Tsy) said that the Government would not under-estimate the workload and challenges to put in place the required legal framework for implementing AEOI. In order to ensure effective implementation of AEOI in Hong Kong, the proposed

legislative amendments to the Inland Revenue Ordinance (Cap. 112) would need to cover the scope of FIs and reportable accounts and possible exemptions, reporting requirements and procedures, the power for the Inland Revenue Department ("IRD") to collect from and access to information of FIs, and penalties for non-compliance. She said that the initial framework had already been included in the consultation paper released in April 2015 and details of the proposed legislative framework were set out in Annex A to the information paper submitted to the Panel (LC Paper No. CB(1)1034/14-15(06)). She added that the Government had conducted briefings for the industry to explain the proposals and collect views from the stakeholders, and received over 30 written submissions so far. The Financial Services and the Treasury Bureau had been working closely with IRD and the Department of Justice in preparing the drafting instructions and would take into account the views and comments received during the public consultation in finalizing the drafting instructions. The Government would update members and relevant stakeholders on the latest developments and endeavour to introduce the amendment bill into LegCo as soon as possible.

Benefits of implementing AEOI and the relevant compliance cost

59. Mr Christopher CHEUNG remarked that while Hong Kong, being an international financial centre, had to uphold its responsibility in international tax cooperation, implementation of AEOI would have limited benefits on Hong Kong given its simple tax regime and the practice of territorial-based taxation. On the other hand, he was concerned that implementation of AEOI would increase the compliance burden and costs on FIs as they would be required to keep and report to IRD a wide range of information relating to their clients. He asked if the Government could consider exempting FIs from reporting on accounts below a certain threshold.

60. PS(Tsy) responded that the AEOI Standard was a global standard applying to all committed jurisdictions across the board and there would be little room for Hong Kong to deviate from the global standard. According to the AEOI Standard, certain accounts were not subject to reporting, such as pre-existing entity accounts below 250,000 US Dollar. She stressed that, when considering the scope of exemptions for FIs and accounts, the Government would apply the overriding criteria as set out under the AEOI Standard.

61. Noting that FIs were already required by law to carry out specific due diligence requirements for Anti-Money Laundering and Counter Terrorist Financing ("AML") purposes, Mr CHAN Kam-lam asked if the reporting requirements and procedures under AEOI could be aligned with those of AML so that they could be simplified, which in turn could minimize compliance costs on FIs and inconvenience caused to account holders. PS(Tsy) took note of Mr

CHAN's views and said that the Administration would endeavour to put in place reporting and due diligence requirements which were essential in the AEOI Standard, but was also mindful of the need to avoid creating undue burden of compliance on FIs and account holders.

62. Mr Kenneth LEUNG expressed concern about the resources implications on IRD, particularly on manpower requirement, arising from the implementation of AEOI and increasing workload in relation to expanding the networks of Comprehensive Avoidance of Double Taxation Agreement ("CDTA") and Tax Information Exchange Agreement ("TIEA"). He also enquired about the progress of development in the information technology ("IT") systems for implementing the information exchange under AEOI.

63. PS(Tsy) agreed that IRD would need to strengthen its manpower resources for implementing AEOI and the Government would consider the need of creating new posts in IRD when necessary taking into account its operational needs. Regarding development of the IT systems in IRD, the Deputy Commissioner of Inland Revenue (Technical) said that IRD was in the process of developing an AEOI Portal which would serve as a secure electronic platform for FIs to submit information and file AEOI returns to IRD. The information would be encrypted before transmission to enhance protection for the information submitted. In the event that FIs would like to develop their own in-house systems to facilitate the submission of information, IRD would examine those systems and allow the use of those systems subject to their compatibility with the AEOI Portal.

Conclusion

64. Concluding the discussion, the Chairman said that the Administration planned to introduce the amendment bill into LegCo in early 2016, and the Panel had no objection to the plan.

VII. Consultation conclusions of proposals to improve the regulatory regime for listed entity auditors

(LC Paper No. CB(1)1034/14-15(08) — Administration's paper on "Proposals to improve the Regulatory Regime for Listed Entity Auditors — Consultation Conclusions"

LC Paper No. CB(1)1034/14-15(09) — Background brief on the proposals to improve the regulatory regime for listed entity auditors prepared by the Legislative Council Secretariat)

Briefing by the Administration

65. At the invitation of the Chairman and with the aid of a powerpoint presentation, the Deputy Secretary for Financial Services and the Treasury (Financial Services)3 ("DS(FS)3") briefed members on the results of the public consultation on the proposals to improve the regulatory regime for listed entity auditors ("LEAs") which was conducted from June to September 2014. He said that an overwhelming majority of the respondents supported the objective and direction of the reform. Having regard to the comments received, the Government had refined and elaborated on some of the proposals. The Government aimed to introduce the relevant amendment bill into the Legislative Council ("LegCo") in the 2016-2017 legislative session.

(Post-meeting note: The notes of the powerpoint presentation (LC Paper No. CB(1)1069/14-15(04)) were issued to members vide Lotus Notes e-mail on 7 July 2015.)

Discussion

Disciplinary mechanism

66. Mr Kenneth LEUNG was concerned that the Administration had retained the proposal in the consultation paper to vest the Financial Reporting Council ("FRC") with direct disciplinary power over irregularities of LEAs instead of entrusting the power to an independent body or committee. Pointing out that disciplinary cases involving members of the Hong Kong Institute of Certified Public Accountants ("HKICPA") were currently handled by statutory Disciplinary Committees independent of HKICPA, he was of the view that the proposed disciplinary mechanism under the new regulatory regime was regressive and failed to address stakeholders' concern about separation between FRC's disciplinary power and inspection and investigation powers. To ensure fairness of the disciplinary mechanism of LEAs, he urged that the Government should consider setting up an independent disciplinary committee under FRC for hearing and deciding on disciplinary cases.

67. In response, DS(FS)3 emphasized that the main reason for the proposed reform was the internationally accepted principle that the auditor regulatory

regime should be independent of the audit profession. The Government had considered the suggestion raised in some written submissions to separate the disciplinary power in respect of LEAs from FRC's inspection and investigation powers under the new regime. However, it should be pointed out that there was no international requirement in auditor regulation to vest the disciplinary power in a body independent of the independent auditor regulator. In fact, in the United States and Canada, the inspection, investigation and disciplinary powers were all vested in their independent auditor regulators. Given that FRC was independent of the audit profession, it would not be deemed to be unfair to LEAs if FRC was empowered to exercise inspection, investigation and disciplinary powers under the new regime. The proposed disciplinary system already provided for a number of safeguards including the right to be heard and the right to appeal to an independent appeals tribunal, with provision for further appeal to the court if leave was granted by the court.

68. In response to a further question from Mr Kenneth LEUNG, DS(FS)3 said that the Government would not consider creating another independent body outside or within FRC to handle disciplinary cases or make disciplinary decisions, but would consider further whether it would be appropriate to involve any person independent of FRC and of the audit profession in the disciplinary process under the auspices of FRC when working out the details of the amendment bill.

Registration of listed entity auditors

69. Mr CHAN Kam-lam expressed support for the reform proposals. Pointing out that any practicing certified public accountants ("CPAs") could undertake audit engagements of listed entities at present but the new regulatory regime required CPAs to be registered as LEAs before they could take up the role of auditors of listed entities, he asked if there would be any change to the qualification requirements for undertaking audit engagements of listed entities. He also enquired about the rationale for the proposed mechanism to require only signing partners of LEAs instead of all auditors involved in audit engagements in respect of listed entities to be registered, and for restricting the scope of reform to LEAs instead of auditors of all companies.

70. DS(FS)3 explained that HKICPA was a professional body performing the dual role of an institute of accountants to help develop the profession and also a statutory body to regulate the profession. This arrangement as applied to auditors was not in line with the international standard that the auditors of public interest entities should be subject to independent oversight. Under the proposed new regime, public interest entities would be defined to mean listed entities in Hong Kong. A new registration system for LEAs to be administered by HKICPA and subject to the independent oversight of FRC was proposed. DS(FS)3 said that since the proposed reform would entail substantial changes

to the existing regulatory regime, it would be prudent for the Government to adopt a step-by-step approach in proceeding with the reform having regard to, among other factors, the implications of the reform on the profession and its impact on FRC's manpower requirement.

71. DS(FS)3 added that the Government had not proposed to change the prevailing qualification and experience requirements for being an LEA for the purpose of the reform, although it should be pointed out that the relevant qualification and experience requirements would always be subject to review by HKICPA (which would be subject to FRC's oversight under the new regime) and, if necessary, modification from time to time. He further clarified that under the proposed registration system, all relevant signing partners of a practice unit undertaking listed entity audit engagements would be required to be registered.

Further stakeholder engagement

72. Ms Starry LEE declared that she was a CPA employed by one of the "big four" accounting firms and had been working in the audit profession for many years. Noting that the Government would continue to engage stakeholders in preparing the relevant amendment bill, she asked how it would engage the relevant stakeholders. She stressed that the Government should not confine its ensuing stakeholder engagement to HKICPA, especially since the interests of audit firms of different sizes might not be identical, there were other relevant professional bodies in the accounting/audit sector, and the reform would also affect listed entities.

73. DS(FS)3 took note of Ms LEE's views and responded that the Government would continue to make use of the pre-existing tripartite forum to engage HKICPA and FRC. He assured members that the Government would also maintain dialogue with other stakeholder groups, including small and medium-sized audit firms and other relevant professional bodies.

Conclusion

74. The Chairman concluded that Panel members raised no objection to the Administration's plan to introduce the amendment bill into LegCo in the 2016-2017 legislative session.

VIII. Any other business

75. There being no other business, the meeting ended at 12:29 pm.

Council Business Division 1
Legislative Council Secretariat
22 September 2015