立法會
Legislative Council

LC Paper No. CB(1)803/15-16
(These minutes have been seen by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of policy briefing cum meeting held on Monday, 15 February 2016 at 2:45 pm in Conference Room 3 of the Legislative Council Complex

Members present : Hon NG Leung-sing, SBS, JP (Chairman)
Hon Christopher CHEUNG Wah-fung, SBS, JP (Deputy Chairman)
Hon James TO Kun-sun
Hon CHAN Kam-lam, SBS, JP
Hon Abraham SHEK Lai-him, GBS, JP
Hon Vincent FANG Kang, SBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon Andrew LEUNG Kwan-yuen, GBS, JP
Hon Starry LEE Wai-king, JP
Hon CHAN Kin-por, BBS, JP
Hon Mrs Regina IP LAU Suk-yee, GBS, JP
Hon LEUNG Kwok-hung
Hon Kenneth LEUNG
Hon Dennis KWOK
Hon SIN Chung-kai, SBS, JP

Members attending : Hon WONG Kwok-hing, BBS, MH
Dr Hon LAM Tai-fai, SBS, JP
Hon Alice MAK Mei-kuen, BBS, JP

Members absent : Hon Albert HO Chun-yan
Hon LEE Cheuk-yan
Hon WONG Ting-kwong, SBS, JP
Hon James TIEN Pei-chun, GBS, JP
Hon Charles Peter MOK, JP

Public officers attending	**:**	Agenda Item IV Mr Norman T. L. CHAN, GBS, JP Chief Executive 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 Mr Howard LEE, JP Acting Deputy Chief Executive (Development) Hong Kong Monetary Authority Agenda Item V Professor 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 Miss Salina YAN, JP Deputy Secretary for Financial Services and the Treasury (Financial Services)1 Mr Eddie CHEUNG Deputy Secretary for Financial Services and the Treasury (Financial Services)2

Mr Paul WONG
Acting Deputy Secretary for Financial Services and the Treasury (Financial Services)3

Agenda Item VI

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

Mr Carlson TONG, SBS, JP
Chairman
Securities and Futures Commission

Mr Ashley ALDER, JP
Chief Executive Officer
Securities and Futures Commission

Mr Paul YEUNG
Commission Secretary
Securities and Futures Commission

Agenda Item VII

Ms Ada CHAN
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)2

Mr Keith LUI
Executive Director (Supervision of Markets)
Securities and Futures Commission

Mr Joseph Lee
Director (Supervision of Markets)
Securities and Futures Commission

Mr Hokinson HO
Senior Manager (Supervision of Markets)
Securities and Futures Commission

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 meetings and matters arising

(LC Paper No. CB(1)540/15-16	—	Minutes of the meeting on 7 December 2015
LC Paper No. CB(1)485/15-16	—	Minutes of the meeting on 4 January 2016)

The minutes of the meetings held on 7 December 2015 and 4 January 2016 were confirmed.

II Information papers issued since the meeting on 4 January 2016

(LC Paper No. CB(1)373/15-16(01)	—	Administration's written response to letter from Hon Charles Peter MOK on issues relating to development of financial technologies in Hong Kong
LC Paper No. CB(1)430/15-16(01)	—	Administration's paper on "Agreement Establishing the ASEAN+3 Macroeconomic Research Office as an International Organization"

LC Paper No. CB(1)475/15-16(01) and (02)	—	A newspaper article dated 7 December 2015 regarding the Government's policy on small coins from a member of the public who had also sent a letter to the Hong Kong Monetary Authority ("HKMA") on the newspaper article (English version only), and HKMA's written response to the member of the public
LC Paper No. CB(1)476/15-16(01)	—	Fourth quarterly report of 2015 on "Employees Compensation Insurance — Reinsurance Coverage for Terrorism")

2. Members noted the information papers issued since the regular meeting held on 4 January 2016.

III Date of next meeting and items for discussion

(LC Paper No. CB(1)440/15-16(01)	—	List of outstanding items for discussion)

3. Members agreed to discuss the following items proposed by the Administration at the next regular meeting rescheduled for 22 March 2016:

(a) Retention of two supernumerary directorate posts in the Financial Services Branch of the Financial Services and the Treasury Bureau; and

(b) Exchange distribution platform for funds.

IV Briefing on the work of Hong Kong Monetary Authority

(LC Paper No. CB(1)440/15-16(04)	—	Paper provided by the Hong Kong Monetary Authority)

Briefing by the Administration

4. At the invitation of the Chairman, the Chief Executive, Hong Kong Monetary Authority ("CE/HKMA"), the Acting Deputy Chief Executive (Development)/HKMA ("DCE(D)/HKMA(atg.)"), 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 the Hong Kong Monetary Authority ("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 Renminbi ("RMB") centre, and investment performance of the Exchange Fund ("EF").

> (*Post-meeting note*: The powerpoint presentation materials (LC Paper No. CB(1)567/15-16(01)) were issued to Members vide Lotus Notes e-mail on 16 February 2016.)

Discussion

Macroeconomic environment and the linked exchange rate system

5. Mr Andrew LEUNG expressed concern about the uncertainties faced by Hong Kong including lackluster performance in the global and local economy, and moderation in the local credit market. Noting that many small and medium enterprises ("SMEs"), especially those in the retail, catering and tourism industries, encountered difficulties in obtaining credits, Mr LEUNG enquired how HKMA would assist SMEs in this regard. Sharing the same concern, Mr Vincent FANG asked whether HKMA had discussed with banks about the slow down in credit growth. Mr CHAN Kin-por enquired whether the moderation in credit growth was attributed to HKMA's measures in this area.

6. Mr Andrew LEUNG, Mr Christopher CHEUNG and Mr Jeffrey LAM expressed concern about the impacts of the riot in Mongkok during the Chinese New Year on the Hong Kong economy. Mr CHEUNG was worried that the incident might accelerate the outflow of capital from Hong Kong.

7. CE/HKMA agreed that it would be difficult for the market to adapt when the economic cycle turned down. With rising interest rates, some enterprises might encounter difficulties, especially for those which had made excessive borrowing during the upward economic cycle. To maintain financial and banking stability, HKMA had implemented seven rounds of countercyclical marcoprudential measures on property mortgage lending and reminded banks to step up credit and liquidity risk management during the

credit upcycle. CE/HKMA added that as HKMA had understood from banks, moderation in credit growth in 2015 was partly attributable to the unwinding of RMB carry trade, and there was no clear sign of tightening in credit for SMEs. DCE(B)/HKMA supplemented that the stable funding requirement introduced by HKMA during the upward economic cycle had helped strengthen banks' liquidity management to enhance their resilience and avoid drastic cutback in credit supply during economic downturn owing to liquidity needs of banks. DCE(B)/HKMA said that had it not been an unwinding of RMB carry trade and repayment of related loans in the second half, the local credit market would likely have registered a high single-digit growth for the whole year of 2015 according to HKMA's estimate in mid-2015.

8. Mr Dennis KOWK sought the assessment of HKMA on Hong Kong's ability to withstand speculative attacks on the Hong Kong dollar ("HKD") and defend the linked exchange rate ("LER") as compared to that in the financial turmoil of 1998. He also asked if HKMA would consult the banking sector on a regime to strengthen the systemic risk buffer so as to enhance their resilience in withstanding external shocks which was similar to the consultation currently conducting by the Bank of England.

9. While appreciating Hong Kong's stronger ability in defending the LER system now due to its larger monetary base as compared to that in 1998, Mr Vincent FANG and Mr Christopher CHEUNG cautioned that the size of many hedge funds had also attained substantial growth since 1998. Mr CHEUNG enquired about measures HKMA would take to strengthen the LER system. Given that Hong Kong was a premier offshore RMB center and that some hedge funds/financial institutions might have been carrying out speculative attacks on RMB, Mr FANG asked if Hong Kong would cooperate with the Mainland in combating speculation on HKD or RMB.

10. Mr LEUNG Kwok-hung enquired if HKMA had been consulted on measures for complementing the Belt and Road Initiative. As implementation of the Belt and Road Initiative would require more RMB lending, with continuous depreciation in RMB, Mr LEUNG was concerned that implementation of the Belt and Road Initiative might have adverse impacts on the financial stability of Hong Kong.

11. CE/HKMA pointed out that Hong Kong was an open market, and foreign exchange transactions and inflows/outflows of capital were not subject to any restriction. HKMA was aware that some media had recently mentioned possible speculative attacks on HKD by some hedge funds. He explained that under the LER system of which the operation was based on the Currency Board principles, the some US$130 billion flown into Hong Kong in the past few

years was being held by EF as US dollar reserves, which could serve as a buffer against capital outflow. CE/HKMA added that in comparison with 1998, Hong Kong's HKD Monetary Base had increased substantially. Hedge funds/financial institutions aiming to short sell HKD and push up the interest rates of HKD in order to reap profits from a crash of the stock market would require massive funds in the order of hundreds of billions. It would be extremely difficult for hedge funds/financial institutions to borrow such a huge sum of HKD for this purpose. CE/HKMA stressed that Hong Kong's monetary and financial systems remained sound and robust. The determination and ability of the Government to defend the LER system was beyond doubt. The public had no cause for panic and should maintain confidence in the LER system. To address systemic risks in the banking sector, DCE(B)/HKMA said that in 2015, HKMA had designated five banks in Hong Kong as domestic systemically important banks which were subject to additional capital buffer.

12. As regards RMB exchange rate volatility, CE/HKMA responded that RMB exchange rate policy was the responsibility of Mainland authorities. That said, HKMA had introduced liquidity measures to facilitate banks' liquidity management and support orderly operation of the offshore RMB market in Hong Kong. On Hong Kong's role in the Belt and Road Initiative, CE/HKMA remarked that Hong Kong was well placed to take up the role of a financial intermediary due to its proximity to the Mainland and status as an international financial centre. Hong Kong could leverage on its competitive edges in financing and capital formation, as well as provision of professional services to help enterprises participating in the Belt and Road Initiative. In addition, currency fluctuation was normal for any economy around the world. Hong Kong was well positioned to help enterprises manage currency and liquidity risk when investing in projects under the Belt and Road Initiative.

Competitiveness and development of Hong Kong's financial industry

13. Mr Jeffrey LAM and Dr LAM Tai-fai noted with concern the HSBC Group's decision to maintain its headquarters in the United Kingdom ("UK"). Mr LAM enquired whether the decision would have negative impact on the development of Hong Kong's financial services industry, and measures HKMA would take to strengthen Hong Kong's status as an international financial centre. Mr Kenneth LEUNG considered that the HSBC Group's decision might have reflected international corporations' concerns about the supply of financial talents and profits tax treatment in Hong Kong, and different interpretation regarding consular protection for Chinese people with the European Union passports.

14. CE/HKMA remarked that HKMA respected the HSBC Group's decision to maintain the status quo. He said that irrespective of the decision, The Hongkong and Shanghai Banking Corporation, headquartered in Hong Kong, had all along been the biggest source of profits for the HSBC Group. The HSBC Group had also indicated that it would continue to use Hong Kong as the headquarters to grow and develop its business in the Asia Pacific region, including the Pearl River Delta. CE/HKMA added that Hong Kong had attracted top-tier financial talents from all over the world. Nevertheless, it was necessary for the Government to step up efforts in training middle-level financial professionals in Hong Kong. In this regard, HKMA had partnered with the industry in enhancing training for private wealth management practitioners. In the coming year, emphasis would be put on training banking practitioners in areas of anti-money laundering and counter-terrorist financing. CE/HKMA added that the Government had introduced a number of measures to enhance the competitiveness of Hong Kong as an international financial centre. For instance, the Financial Institutions (Resolution) Bill and the Inland Revenue (Amendment) (No. 4) Bill 2015 ("IR Bill") had been introduced into the Legislative Council ("LegCo") to provide for a cross-sectoral resolution regime for financial institutions in Hong Kong and promote the development of Hong Kong as a hub for corporate treasury centres ("CTCs") respectively. DCE(D)/HKMA(atg.) advised that HKMA was aware of the industry's views to further optimise the proposed tax measures for CTCs, and would continue to discuss with the Inland Revenue Department on the relevant issues.

15. Mr CHAN Kin-por appreciated the Administration's effort in promoting Hong Kong as a CTC hub, which he considered would help develop headquarters economy in Hong Kong and create more jobs for the financial services and related professional services sectors. He sought HKMA's assessment on the number of CTCs to be established in Hong Kong upon passage of IR Bill, and enquired about measures implemented by HKMA to encourage international corporations to set up headquarters or regional offices in Hong Kong.

16. DCE(D)/HKMA(atg.) explained that it took time for corporations to assess whether to establish CTCs in Hong Kong. HKMA had been liaising with a number of multinational corporations to gauge their views, and had received positive feedback.

Performance of the Exchange Fund

17. Dr LAM Tai-fai expressed disappointment about EF's huge investment loss of $18.3 billion in 2015, in particular the persistent loss in foreign exchange in recent years. He enquired about EF's performance in 2015 as

compared to other sovereign funds, including those of Singapore and the Republic of Korea, and measures to improve the performance of EF in the future.

18. CE/HKMA responded that HKMA adopted a long-term asset allocation strategy with a view to achieving a relatively stable return for EF investment in the medium to long term. It would be highly risky for EF to aim for gains using short-term speculation. CE/HKMA added that even for other big sovereign wealth funds, there was no guarantee that they would not suffer investment losses amid a volatile and difficult global financial environment. The EF had achieved on average a 5% annual investment gain between 1994 and 2015 while the composite consumer price index over the same period was 2.2%.

Volatilities in the stock market and investor protection

19. Mr SIN Chung-kai was concerned that with increasing interconnection between the Mainland and Hong Kong securities markets and differences in their regulatory regimes, what measures HKMA would take to prevent the negative impact on the Hong Kong market arising from volatilities in the Mainland market. Mr SIN also enquired about the number of complaints relating to RMB derivative products received by HKMA recently, and the progress of investigation.

20. CE/HKMA observed that the operation of the Hong Kong financial markets, including the payment systems, had remained orderly in recent months and the liquidity support provided by HKMA had helped banks cope with market stress. Being a regulator, HKMA would strive to maintain the soundness of the financial infrastructure. CE/HKMA said that the regulatory regimes of Hong Kong and the Mainland were different. However, with increasing interconnection between the Mainland and Hong Kong financial markets, it was natural that the two markets would be affected by each other. As regards the selling of RMB accumulator products, DCE(B)/HKMA said that there were some 40 related complaints being processed by HKMA.

Measures on the property market

21. Mrs Regina IP enquired when HKMA would implement measures, including relaxing the countercyclical marcoprudential measures on property mortgage lending, to counteract the downward pressure in the local property market, and the factors HKMA would take into account during the process.

22. CE/HKMA said that HKMA had implemented seven rounds of countercyclical marcoprudential measures during the upward cycle of the property market to maintain banking stability. These measures had helped contain the existing loan-to-value ratio to around 50%, and hence the risk of a surge in the number of negative equities in a downcycle should be reduced. HKMA would consider suitably relaxing the measures in phases only when a downward cycle in the property market was confirmed. But more time was needed to observe the development of the property cycle. In making such decisions, HKMA would consider a host of factors in a holistic manner.

V Briefing by the Secretary for Financial Services and the Treasury on relevant policy initiatives in the Chief Executive's 2016 Policy Address

(LC Paper No. CB(1)440/15-16(03)	—	Administration's paper on 2016 Policy Address - Policy Initiatives of the Financial Services and the Treasury Bureau
issued on 13 January 2016	—	Address by the Chief Executive at the Legislative Council meeting on 13 January 2016)

Briefing by the Administration

23. 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's 2016 Policy Address by highlighting the following areas of work set out in the Administration's paper (LC Paper No. CB(1)440/15-16(03)):

(a) attracting multinational and Mainland corporations to establish CTCs in Hong Kong through enhancing the interest deduction rules and introducing profits tax concession for qualifying CTCs;

(b) consolidating Hong Kong's position as a leading asset management centre in Asia through various initiatives, including the Mainland-Hong Kong Mutual Recognition of Funds Arrangement, profits tax exemption for private equity funds, and introduction of a new open-ended fund company structure;

(c) providing support to the operation of the Asian Infrastructure Investment Bank ("AIIB");

(d) promoting Hong Kong as a financial technologies ("fintech") hub and supporting the work of the Steering Group on Fintech;

(e) establishment of a resolution regime for financial institutions in Hong Kong in line with the latest international standards;

(f) enhancing protection for borrowers (e.g. examining the existing regulatory arrangements of money lenders and related intermediaries); and

(g) putting in place the legislative framework for implementing automatic exchange of financial account information in tax matters in Hong Kong, with a view to commencing the first exchanges with appropriate partners in 2018.

(*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)574/15-16(01) on 18 February 2016.)

Discussion

Regulation of money lenders and related financial intermediaries

24. Mr WONG Kwok-hing and Miss Alice MAK remarked that the Hong Kong Federation of Trade Unions had received numerous complaints from members of the public who were victims of frauds of money lenders and related financial intermediaries. They expressed concern about loopholes in the Money Lenders Ordinance (Cap. 163) ("MLO") and other relevant legislation which had rendered the Police's enforcement actions ineffective. They enquired about the timetable for reviewing MLO to address the problem, and measures in the interim to enhance protection for borrowers.

25. SFST responded that the Administration attached great importance to tackling malpractices involving money lenders and related financial intermediaries, and would take forward the review in a prudent manner. The Administration was studying the Police's experience in taking enforcement actions under MLO and, in this context, would not rule out the possibility of reviewing the relevant provisions in MLO. The Administration planned to brief the Panel on proposed improvement measures in April 2016. Meanwhile,

the Police would continue to take enforcement actions against malpractices of money lenders and financial intermediaries. Indeed, it was observed that enforcement actions taken in recent months had been effective. Moreover, the Administration would enhance public education on related issues, including increasing resources to enhance support services provided by non-governmental organizations to people in financial distress.

Regulation of the trading of Loco London gold

26. Mr WONG Kwok-hing expressed concern about fraud cases involving over-the-counter trading of Loco London gold. He urged the Administration to step up enforcement actions and make reference to the experience of Macau to introduce specific legislation to combat illegal trading activities. SFST explained that there were difficulties in regulating the trading of London gold through specific legislative means. The Administration considered it more appropriate to tackle related issues through strengthening enforcement actions against fraudulent activities and enhancing investor education.

Development of the local bond market

27. Mr Jeffrey LAM expressed concern about the slow development in the Hong Kong bond market which he considered not commensurate with Hong Kong's status as an international financial centre. Noting that a robust bond market could enhance Hong Kong's financial infrastructure and diversify financing platforms for corporations, he enquired about the Administration's initiatives in promoting development of the local bond market.

28. SFST pointed out that the development of HKD bonds was to some extent constrained, as institutional investors, who were the major investors in the local bond market, generally preferred US dollar ("USD") bonds given their greater liquidity in the international financial markets. The Government and HKMA had implemented the Government Bond Programme in order to boost the development of the HKD bond market. The Government would continue to promote the development of Islamic bonds and offshore Renminbi bonds (i.e. "dim-sum bonds") in Hong Kong, with a view to establishing Hong Kong's status as a regional bond market.

Fintech development

29. Mr Andrew LEUNG remarked that Hong Kong lagged behind other major cities in the development of fintech. The slow development in introducing an uncertificated securities market regime in Hong Kong was a case in point. He cautioned about over-regulation in the financial services

industry discouraging the development of new technologies by industry players, and urged that, instead of adhering strictly to technology neutrality, the Government should cut red tape in fostering the growth of fintech. Echoing the concern, Mr Christopher CHEUNG said that the Securities and Futures Ordinance (Cap. 571) had constrained securities firms in adopting new fintech in various areas, such as enabling opening of securities accounts through electronic means and providing electronic trading services to clients. He enquired about initiatives to facilitate the adoption of fintech by securities firms.

30. SFST responded that the Steering Group on Fintech, of which he was the Chairman, had completed its work and would soon release its report. The Steering Group recognized Hong Kong's strengths in fintech development, including the robust financial infrastructure, abundant supply of information technology talents, and strong demand for fintech services from financial institutions and related sectors. He stressed that the Government was committed to developing Hong Kong into a fintech hub and would continue to engage the industry in formulating appropriate policies and measures. The Government would also endeavour to strike a balance between market development and investor protection. He added that it took time for the industry to adopt new fintech as some players might need to make fundamental changes to their information technology systems. The Government would explore measures to encourage industry players to invest in fintech. SFST said that the regulatory regimes for the financial markets were technology-neutral. The Securities and Futures Commission ("SFC") was aware of constraints faced by securities firms in adopting new fintech in their operations. The Government and SFC had been discussing related issues, and would continue to explore measures in collaboration with the industry to resolve the issues, such as modifying the rules relating to account opening. As regards development of the uncertificated securities market regime in Hong Kong, SFST said that the new regime would have impact on the operation of market players, and therefore it would take time for the relevant parties to resolve related issues to ensure a smooth transition to the new regime. He remarked that there had been significant progress in the preparatory work, and he looked forward to the implementation of an uncertificated securities market regime before long.

Operation of the financial markets under volatile external environment

31. The Chairman sought details on the Administration's precautionary measures to ensure the proper operation of the financial markets and bolster investor confidence in Hong Kong's financial system when facing uncertainties in the external environment. Mr Jeffrey LAM expressed concern whether the

riot in Mongkok on 9 February 2016 had adversely affected Hong Kong's reputation as an international financial centre.

32. SFST responded that over the years, the Government and financial regulators had put in place various precautionary measures aiming to strengthen financial market infrastructure and resilience of the local financial system in counteracting external risks, maintaining financial stability and ensuring smooth operation of the financial markets during crisis. Such measures included measures taken by HKMA to safeguard the linked exchange rate system, and risk management measures implemented by SFC to ensure proper functioning of the securities markets during market volatilities. He added that despite that there had been rumours about speculative attacks on HKD recently, capital outflow from Hong Kong had not resulted in a surge in the HKD interbank interest rates. On measures to bolster investor confidence, SFST said that the Government endeavoured to maintain high transparency in financial policies and regulatory measures, and strengthen investor education in risk management through different channels. HKMA had explained to the public on various occasions the market conditions and the soundness of Hong Kong's financial system. As regards the recent riot in Mongkok, SFST said that Hong Kong had a good reputation as a civilized and law-abiding city which had underpinned its status as an international financial centre. He cautioned that continued social unrest could tarnish Hong Kong's reputation.

Hong Kong's participation in the Asian Infrastructure Investment Bank and Belt and Road Initiative

33. The Chairman relayed support of the financial services industry for Hong Kong to join AIIB. He stressed the need to enhance talent training and exchange between Hong Kong and the Mainland, and enquired about the Administration's plans in enhancing talent training in the financial services industry for meeting the needs arising from implementation of the Belt and Road Initiative.

34. Noting that the Belt and Road Initiative would bring enormous opportunities and many jobs to Hong Kong, Mr Jeffrey LAM suggested that FSTB should step up publicity on the Initiative in collaboration with the relevant bureaux, including the Commerce and Economic Development Bureau, Innovation and Technology Bureau, and Education Bureau, in order to enhance public awareness of the subject. He remarked that the business sector had urged the Government to actively pursue the establishment of AIIB's CTC in Hong Kong. He called on the Administration to raise the matter with the Central Government.

35. SFST responded that there was adequate supply of financial talents in Hong Kong, and professionals in the relevant fields, including legal and accounting, were well qualified to support the operation of AIIB in aspects such as project financing and bond issuance. While education policies were not under the purview of FSTB, SFST said that to complement the implementation of the Belt and Road Initiative, the 2016 Policy Address had included education-related initiatives for local students to gain a deeper understanding of the Belt and Road Initiative and the cultures of countries along the route. He believed that the relevant bureaux/departments would follow up to formulate the details. SFST took note of Mr Jeffrey LAM's views about enhancing public awareness on the Belt and Road Initiative and pointed out that the Government would collaborate with the industry in working out the details. He added that the Government was discussing with the Central Government for Hong Kong to join AIIB, and would strive to encourage AIIB to use Hong Kong's professional services, corporate treasury services and the bond issuance platform.

VI Budget of the Securities and Futures Commission for the financial year 2016-17

(LC Paper No. CB(1)440/15-16(05) — Administration's paper on "Securities and Futures Commission Budget for the Financial Year 2016-17"

LC Paper No. CB(1)440/15-16(06) — Background brief on the annual budgets of the Securities and Futures Commission prepared by the Legislative Council Secretariat)

Briefing by the Securities and Futures Commission

36. At the invitation of the Chairman, the Chairman, SFC ("C/SFC") briefed members on SFC's proposed budget for 2016-2017 as set out in his speaking note.

(*Post-meeting note*: The speaking note was issued to members vide LC Paper No. CB(1)574/15-16(02) on 18 February 2016.)

Discussion

Headcounts and professional fees

37. Mr Christopher CHEUNG welcomed SFC's proposal to extend the annual licensing fee holiday for licensed intermediaries for another two years from 1 April 2016. However, he was concerned that the proposed headcount increase in the Intermediaries Division might imply tightening of supervision of intermediaries. Noting that suspension of trading of newly listed companies within the first year of their listings had become more common, Mr CHEUNG opined that SFC should step up its efforts on that front rather than tightening regulation over intermediaries.

38. C/SFC and the Chief Executive Officer, SFC ("CEO/SFC") responded that the number of corporate licensing applications had increased by 29% in the 12-month period ending in September 2015 compared to the preceding 12-month period, and the number of individual licensing applications had also increased by 14% in the same period. The proposed headcount increase in the Intermediaries Division was to cope with the increased number of licensed intermediaries, and was not aimed at tightening regulation of small and medium-sized brokers. CEO/SFC added that there had also been a 24% growth in the investigation caseload from October 2014 to October 2015, and hence a manpower request for the Enforcement Division had also been made in the 2016-2017 budget.

39. Noting continuous substantial increase in SFC's expenditure on professional and legal fees, Mr Jeffrey LAM asked if SFC had considered streamlining its investigation procedures in order to save costs. He expressed concern whether the recent riot in Mongkok could discourage expatriates from coming to work in Hong Kong, thereby reducing the supply of professionals and pushing up the fees concerned.

40. C/SFC said that SFC's regulatory objectives included protecting the investing public and ensuring the quality of the securities and futures markets, and such responsibilities were carried out irrespective of economic cycles. The professionals engaged by SFC were mainly legal and financial experts, especially those experienced in market regulation. The size of professional and legal fees reflected the high demand for such professional services in the market. C/SFC added that it was difficult to predict the future supply and costs of professional services.

Client Agreement Requirements

41. Mr Christopher CHEUNG conveyed the industry's concerns regarding the implementation of the Client Agreement Requirements, in particular as this had raised questions regarding the application of the Suitability Requirement under the Code of Conduct for Persons Licensed by or Registered with SFC ("the Code") during the recent consultation on the Client Agreement Requirements.

42. Mr Andrew LEUNG remarked that it might be difficult for intermediaries to determine whether certain financial products were suitable for their clients. He expressed concern that the Suitability Requirement was unduly burdensome for small brokers, and suggested that SFC should consider waiving the Suitability Requirement for listed stocks given their less complex nature as compared to derivative products. He urged that SFC should strike a proper balance between market regulation and market development. He also stressed the need for SFC to issue a guidance note to clarify issues relating to the Suitability Requirement as early as possible.

43. C/SFC said that the Suitability Requirement had been an existing requirement of the Code for many years and it had not been changed as a result of the Client Agreement Requirements. As always, it should be the intermediaries' responsibility to determine whether a particular financial product was suitable for a particular client based on his/her own circumstances. Having regard to the feedback of the Client Agreement Requirements consultation, SFC decided that a new clause be added in client agreements to the effect that if an intermediary solicited the sale of or recommended any financial product to a client, the financial product must be reasonably suitable for the client. He remarked that listed stocks would not necessarily be less risky than other financial products, and hence they should not be excluded from the Suitability Requirement.

44. CEO/SFC supplemented that SFC had conducted two rounds of public consultations on the Client Agreement Requirements and had taken into account views of investors and the industry (including investment and securities firms of different sizes). SFC was of the view that many existing client agreements were unfair to the clients. He reiterated that there was no change to the existing Suitability Requirement, which had already been codified for many years. If intermediaries were currently in compliance with the Suitability Requirement, they should not have any issue with the Client Agreement Requirements. The new clause in the client agreements would just enable aggrieved clients to take legal action for breach of contract where there was a suitability failing causing loss. CEO/SFC clarified that the Suitability

Requirement would only be triggered when an intermediary solicited the sale of or recommended a financial product to clients, and would not be triggered by merely executing client orders. Moreover, the Suitability Requirement was closely linked to the Know-Your-Client ("KYC") requirement which applied to all intermediaries. Client information obtained through the KYC process should enable intermediaries to determine whether it was suitable to recommend certain financial products to a particular client.

45. C/SFC and CEO/SFC emphasized that SFC paid heed to industry's concerns regarding the Suitability Requirement arising from the consultation on Client Agreement Requirements. There would be a transitional period of 18 months before the proposed amendments would come into effect. Meanwhile, SFC would study the ways in which the Suitability Requirement should operate in various situations, such as its application to products sold on automated platforms. SFC would continue to engage industry stakeholders, including small and medium-sized brokers, and would seek to clarify misunderstandings about applications of the Suitability Requirement. It was hoped that some form of guidance could be issued in 2016.

Regulatory work and powers of the Securities and Futures Commission

46. Mr LEUNG Kwok-hung expressed concern about the trend of "backdoor listings" of Mainland companies through purchasing shell companies listed in Hong Kong. He enquired about SFC's measures to strengthen regulation of backdoor listing in protecting investors. Sharing the concern, Mr Kenneth LEUNG was worried that backdoor listings would have negative impact on the quality of the Hong Kong securities markets as the regulatory and financial requirements of initial public offering ("IPO") exercises were not applicable to backdoor-listed companies.

47. C/SFC and CEO/SFC said that companies should be listed through a proper IPO process which included a mechanism to check the quality of the companies concerned for protection of investors. SFC noted the concern about companies not qualified for listing entering the market through backdoor listings and reverse takeovers. SFC and the Hong Kong Exchanges and Clearing Limited ("HKEX") were reviewing whether the current rules were sufficient to deal with backdoor listings, and whether there were any abuses. On the timetable of the review and division of work between SFC and HKEX, CEO/SFC said that HKEX was the frontline regulator of listing matters but changes to the Listing Rules could only be made with the approval of SFC. It was expected that the review would complete within 2016.

48. Mr Kenneth LEUNG expressed grave concern about HKEX's proposal to introduce a third board (in addition to the existing Main Board and the Growth Enterprise Market) which he considered might put market quality at risk. He sought SFC's view on the proposal.

49. CEO/SFC said that the proposed third board was apparently targeted at smaller-sized companies which had a higher risk of failure. SFC had not been provided with any details of the proposal. He commented that the risks posed to investors might be significant and any proposal must be accompanied by adequate measures to address such risks.

50. Mr Kenneth LEUNG commented that the dual role of HKEX as a listed company and the frontline regulator of listing matters had given rise to conflict of interest. He asked whether SFC would consider taking over HKEX's role as the frontline regulator. He commented that the independence of the Listing Committee was in question, and called on the Administration and SFC to review the regulatory model.

51. C/SFC responded that under the current regulatory regime, the enforcement of the Listing Rules was overseen by the independent Listing Committee. SFC could have oversight of listing matters through the dual filing arrangements. SFC would make its best endeavours to ensure the independence and effectiveness of the Listing Committee.

52. With continued financial cooperation and interconnection between the Hong Kong and Mainland securities markets through channels such as the Shanghai-Hong Kong Stock Connect ("S-HK SC") and the Shenzhen-Hong Kong Stock Connect, Mr SIN Chung-kai expressed concern about increasing risks the Hong Kong market was exposed to arising from volatilities in the Mainland market. Due to differences in the regulatory regimes of Hong Kong and the Mainland, the Mainland's measures to stabilize and regulate its securities markets, such as the "circuit breaker" mechanism and investigation relating to "malicious short selling", might pose regulatory risks to investors in Hong Kong. He asked if SFC would put in place defensive mechanisms to protect the integrity of the Hong Kong market.

53. C/SFC and CEO/SFC responded that to protect the integrity of the Hong Kong market, increased connection between the Hong Kong and Mainland or overseas markets must be complemented by an equivalent level of cooperation among the regulators. To this end, SFC had entered into a Memorandum of Understanding ("MoU") with the China Securities Regulatory Commission ("CSRC") aiming to strengthen cross-boundary regulatory and enforcement cooperation to underpin S-HK SC. Matters covered by the MoU

included, among others, sharing of information and joint investigation by the regulators. SFC endeavoured to ensure that sufficient information could be obtained from the Mainland regulators to deal with misconduct of Mainland companies listed in Hong Kong. C/SFC stressed that as the Hong Kong market was an open market, it could not be immune from external risks. SFC would continue to perform its regulatory functions in accordance with the laws of Hong Kong, and strengthen cooperation with CSRC in the face of increasing connection between the Hong Kong and the Mainland markets.

Office premises of the Securities and Futures Commission

54. Mr Andrew LEUNG asked whether SFC would consider using its reserves to purchase office premises for its long-term development. C/SFC responded that the lease for SFC's current premises had provided for termination rights in 2017 and 2020. SFC would consider acquiring its own property and in due course commence a review of its property acquisition strategy to map out the options. C/SFC supplemented that SFC had projected a budget deficit of $398 million for 2016-2017. Unless there were substantial changes to SFC's income and expenditure, the reserves were expected to fall below twice of its estimated annual operating expenses in four years.

Uncertificated securities market regime

55. Mr Jeffrey LAM enquired about the progress in developing the uncertificated securities market regime in Hong Kong. Deputy Secretary for Financial Services and the Treasury (Financial Services)1 responded that following the enactment of the relevant legislation in 2015, a working group among SFC, HKEX and share registrars had been established to work out the operational details of the regime and the necessary subsidiary legislation. The work had taken considerable time because it was necessary to revamp existing market practices. It was envisaged that implementation of the regime would require the making of up to 10 pieces of subsidiary legislation. The target was to consult the market on the detailed implementation proposals within 2016.

Conclusion

56. The Chairman concluded that Panel members had no objection to SFC's proposed budget for 2016-2017 which would be submitted to the Financial Secretary for approval.

VII Proposed expansion of the scope of the short position reporting regime in Hong Kong

(LC Paper No. CB(1)440/15-16(07)	—	Administration's paper on "Proposed expansion of the scope of the short position reporting regime in Hong Kong"
LC Paper No. CB(1)440/15-16(08)	—	Background brief on the short position reporting regime of Hong Kong prepared by the Legislative Council Secretariat
LC Paper No. CB(1)419/15-16(01)	—	Submission from a member of the public on the proposed expansion of the scope of the short position reporting regime in Hong Kong)

Briefing by the Securities and Futures Commission

57. At the invitation of the Chairman, Senior Manager (Supervision of Markets), Securities and Futures Commission briefed members on the Securities and Futures Commission's ("SFC") proposal to expand the scope of the short position reporting regime in Hong Kong to cover all securities that could be short sold. Subject to members' views, the Administration planned to table the relevant subsidiary legislation before LegCo for negative vetting in March 2016.

Discussion

Regulation of short shelling activities

58. The Chairman enquired about the review of the existing short position reporting regime since it was first introduced in June 2012. He and Mr Kenneth LEUNG asked whether SFC would consider suspending short selling activities under extreme market situations.

59. Executive Director (Supervision of Markets), Securities and Futures Commission ("ED(SM)/SFC") responded that taking into account different views from stakeholders on the proposed short position reporting regime in 2012, SFC then decided that the regime should cover only the constituent stocks of Hang Seng Index, Hang Seng China Enterprises Index ("HSCEI") and other financial stocks specified by SFC. Having regard to developments in short selling activities since 2012, such as significant growth in short selling activities of securities not covered in the reporting regime, including collective investment schemes (e.g. exchange traded funds, Real Estate Investment Trusts and other Unit Trusts/Mutual Funds), SFC had proposed to expand the scope of the reporting regime.

60. On the suspension of short selling activities, ED(SM)/SFC remarked that during the global financial crisis in 2008, a number of countries including the United States ("US"), Australia and some EU member countries had temporarily suspended short selling activities. It was later considered more appropriate to implement a short position reporting regime in order to better understand short selling activities and enhance market transparency instead of banning short selling activities. ED(SM)/SFC added that in formulating regulatory measures on short selling activities, SFC would strike a balance between facilitating market development and maintaining market orderliness and stability.

Regulatory cooperation between Hong Kong and the Mainland

61. With increasing interconnection between the Mainland and Hong Kong market through implementation of measures such as the Shanghai-Hong Kong Stock Connect ("SH-HK SC"), Mr LEUNG Kwok-hung was concerned how regulators of both sides would combat short selling activities aiming to manipulate the market. Mr Kenneth LEUNG sought details on the regulatory co-operation between SFC and CSRC, including mutual assistance in taking enforcement actions against shorting selling activities in their markets, and addressing regulatory loopholes arising from differences between their regulatory regimes.

62. On the cooperation between SFC and regulators of other jurisdictions including the Mainland, ED(SM)/SFC pointed out that while SFC had signed agreements under the International Organization of Securities Commissions with other regulators for providing mutual assistance in investigation and enforcement, regulators of other jurisdictions could not take enforcement actions by themselves in Hong Kong. As regards the short selling regimes in the Hong Kong and the Mainland, ED(SM)/SFC clarified that Hong Kong investors could not easily short sell A-shares through SH-HK SC and Mainland

investors were not permitted to conduct short selling in the Hong Kong market. Short selling, being a highly sophisticated risk management tool usually engaged by institutional investors, was not encouraged in the Mainland given that most Mainland investors were retail investors. ED(SM)/SFC added that as currently some H-shares were not constituent stocks of HSCEI, the proposed expansion in the scope of the short position reporting regime could enhance transparency of short selling activities in Hong Kong.

Implementation of circuit breaker systems in securities markets

63. The Chairman enquired if implementation of a circuit breaker system in the securities market could help curb malicious short selling activities. ED(SM)/SFC advised that the following types of circuit-breakers were implemented in major securities markets in the world:

(a) the circuit-breaker system in the US was implemented at the market level and would be invoked when the percentage change of a major market index exceeded a specified level;

(b) the circuit-breaker system in some Asian markets including the one previously implemented in the Mainland, was to specify a percentage range within which the price of individual stocks was allowed to move; and

(c) the circuit-breaker implemented in some EU countries was at the stock level, and would be invoked for individual stocks when the percentage change in the price of the stock exceeded a specified level.

Conclusion

64. The Chairman said that members had no objection to the Administration tabling the relevant subsidiary legislation before LegCo in March 2016.

VIII Any other business

65. There being no other business, the meeting ended at 5:56 pm.

Council Business Division 1
Legislative Council Secretariat
18 April 2016