

LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS
2017 Policy Address
Policy Initiatives of the Financial Services and the Treasury Bureau

INTRODUCTION

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

FINANCIAL SERVICES

2. The financial services industry has been an important pillar of the Hong Kong economy, contributing to one-sixth of our Gross Domestic Product and providing 250 000 jobs which account for over 6% of the working population. Hong Kong's position as the world's financial centre and its sound financial system are also widely recognised. In the World Competitiveness Yearbook 2016 published by the Institute for Management Development ("IMD") in Lausanne of Switzerland in May last year, Hong Kong was not only considered the world's most competitive economy, it also topped the ranking in finance efficiency. Following the 2016 Article IV Consultation, the International Monetary Fund Mission commended Hong Kong for its strong policy framework,

robust oversight of the financial system and ample buffers, which would stand the economy in good stead to meet challenges ahead.

3. However, the global economy and financial market will continue to be subject to considerable challenges. First, the United States (“US”) Federal Reserve has raised its benchmark interest rates again in December last year, and the future pace of its interest rate hikes remains highly uncertain. At the same time, monetary policy of European Central Bank and other major central banks remains loose, leading to highly unpredictable monetary environment and capital flow. In addition, the new US administration’s policy directions and their impact on economic performance, the evolving development of Brexit, and general elections in a number of European economies will all add uncertainties to the geopolitical and economic outlook.

4. The Government and regulators will stay vigilant amidst the potential volatility in the global financial markets, and ensure the proper functioning of our financial system. We will closely monitor the latest development of the global and local financial markets, and will act swiftly as and when necessary. At the same time, the Government will continue to press ahead with various initiatives to support the asset management industry, advance financial cooperation with the Mainland and further develop our offshore Reminbi (“RMB”) business, encourage the industry to innovate and apply

technology, and enhance market infrastructure and quality, with a view to boosting investor confidence, so as to consolidate Hong Kong's leading position as an international financial centre.

New Initiatives

(a) Auditor Regulatory Reform

5. The Government will amend the relevant legislation to improve the existing regulatory regime for listed entity auditors in order to enhance the independence of the regime from the audit profession, thereby ensuring that the regime is benchmarked against international standards and practices and maintaining the confidence of investors in Hong Kong's overall financial regulatory regime with regard to the capital market. We expect that the amendment bill can be introduced into the Legislative Council ("LegCo") in the second quarter of this year.

(b) Combating money laundering and terrorist financing

6. In light of the constantly changing financial market and security landscapes, we need to enhance Hong Kong's regulatory regime for combating money laundering and terrorist financing, having regard to the international

standards set by the Financial Action Task Force (FATF), thereby safeguarding the integrity of our business environment and reputation as an international financial centre.

7. Firstly, we propose amending the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance to prescribe statutory customer due diligence and record-keeping requirements applicable to certain professions (i.e. solicitors, accountants, real estate agents, and trust or company service providers (“TCSPs”)) when they engage in specified transactions; and to introduce a licensing regime for TCSPs, whereby they will be required to apply for a licence from the Registrar of Companies and satisfy a “fit-and-proper” test before they can provide trust or company services as a business for the public.

8. We also propose amending the Companies Ordinance to require companies incorporated in Hong Kong to take reasonable steps to ascertain the individuals who (and the legal entities which) have significant control over a company, give notice to them, and obtain accurate and up-to-date information about their identities. Relevant companies must maintain a register of people with significant control over the company, containing required particulars of their identities, and provide it for public inspection upon request.

9. We are currently conducting a two-month consultation on the above proposals. Depending on the outcome of consultation, we will refine our legislative proposals, with a view to introducing the two amendment bills into LegCo by the middle of this year.

Ongoing Initiatives

Promoting Market Development

(a) Mainland opportunities

10. We will capitalise on the opportunities arising from the implementation of the National 13th Five-year Plan and the Belt and Road Initiative by enhancing Hong Kong's position as a major investment and financing platform for Mainland and overseas enterprises as well as a global hub for offshore RMB business, and at the same time serving as an important link between our country and economies along the Belt and Road.

11. In July last year, the Hong Kong Monetary Authority ("HKMA") established the Infrastructure Financing Facilitation Office ("IFFO") to facilitate infrastructure investments and their financing through collaboration with a cluster

of key stakeholders as business partners. So far, over 60 organisations from the Mainland, overseas and Hong Kong have joined IFFO as partners, such as multilateral financial agencies and development banks, public and private sector investors, financial institutions, international business federations, etc.

(b) *The Asia Infrastructure Investment Bank (“AIIB”)*

12. Hong Kong has been officially invited to join the AIIB, and the Government will complete the admission of Hong Kong as a non-sovereign member of the AIIB as soon as possible. We will continue to seek the AIIB’s agreement to set up a sub-office in Hong Kong, as well as to leverage Hong Kong’s capital markets, asset management professionals and various financial products to support the operation of the AIIB in areas such as project financing, bond issuance, investment, financial management and foreign exchange management.

(c) *Further advancing financial cooperation with the Mainland and offshore RMB business*

13. Following the successful implementation of Shanghai-Hong Kong Stock Connect in 2014, the launch of Shenzhen-Hong Kong Stock Connect in December 2016 was a major milestone in deepening mutual access between the

capital markets in Hong Kong and the Mainland. Shenzhen-Hong Kong Stock Connect has been operating smoothly since its launch, facilitating the further opening up of the Mainland's capital markets, and the internationalisation of RMB. It also enables international investors to invest more widely in the Mainland's markets through Hong Kong's markets, thereby reinforcing Hong Kong's position as an international financial centre and a global offshore RMB business hub, and creating better conditions for the development of Hong Kong's financial services industry. We will continue to closely monitor the operation of Shenzhen-Hong Kong Stock Connect with the regulatory authorities and the Hong Kong Exchanges and Clearing Limited, and promote the implementation of mutual access of exchange-traded funds to expand the scope of eligible securities for trading and provide more investment opportunities and convenience for investors.

14. Hong Kong continues to be the world's largest offshore RMB business hub, with a leading position in RMB settlement, financing and asset management. As at end November last year, RMB deposits and outstanding RMB certificates of deposit amounted to over RMB700 billion. The outstanding RMB loan amounted to RMB300 billion. According to a report by Society for Worldwide Interbank Financial Telecommunication (SWIFT), in the first three quarters of last year, around 70% of the world's RMB payment transactions were processed via Hong Kong. In addition, as revealed from the

Bank of International Settlements' triennial survey findings on the foreign exchange market last year, Hong Kong continued to rank top in terms of the volume of RMB foreign exchange transactions, with a daily average of USD77 billion equivalent in April last year.

15. We will continue to closely engage relevant Mainland authorities to seek more policy headroom for expanding the channels for two-way cross-border RMB fund flows and strengthening financial cooperation with the Mainland. We will also keep up efforts to enhance financial infrastructure and strengthen RMB business links with overseas markets in order to facilitate RMB business activities between Hong Kong banks and overseas financial institutions and enterprises.

(d) Consolidating Hong Kong's position as a premier asset management centre in Asia-Pacific

16. We will continue to take advantage of the impetus in wealth creation in Asia, as well as the opportunities associated with the continued liberalisation of the financial market in the Mainland. We will, through an array of measures, attract more funds of various types to base and operate business in Hong Kong so as to sharpen Hong Kong's competitive edge as a premier international asset management centre. These measures include removing existing limitation in the

legal structure, broadening the variety and scope of our fund business, as well as facilitating portfolio allocation by investors.

17. Following passage of the Amendment Bill by LegCo in June last year to introduce a legal framework for the open-ended fund company (“OFC”) structure in Hong Kong, the Securities and Futures Commission (“SFC”) and relevant departments are formulating the relevant subsidiary legislation and code to set out the operational and procedural details. SFC expects to consult the public on them later this year, with a view to implementing the OFC regime as soon as practicable. The new regime will help diversify Hong Kong’s fund domiciliation platform and is conducive to attracting more funds to domicile in Hong Kong, thereby deepening and broadening our asset management industry.

18. The Mainland-Hong Kong Mutual Recognition of Funds Arrangement in operation since July 2015 was the first arrangement for mutual recognition of funds established by our country. The arrangement has been running smoothly so far. Separately, SFC reached an agreement with Switzerland in December last year, allowing eligible public funds of both places to be distributed in each other’s market through a streamlined vetting process. This arrangement marks the first time for Hong Kong funds to gain direct access to the investing public in a European market, and helps expand the distribution network for Hong Kong’s

fund industry, provides more product choices for local investors, and also attracts more funds to domicile in Hong Kong.

(e) Silver Bond Pilot Scheme

19. The market response to the first Silver Bond issued in August last year was satisfactory. We will continue to implement the two-year Silver Bond Pilot Scheme and provide an investment product with steady returns for senior residents in Hong Kong, while encouraging financial institutions to tap into the immense potential of this “silver market” by introducing a wider spectrum of appropriate products.

(f) Financial technologies (“Fintech”)

20. To develop Hong Kong as a Fintech hub, the Government in association with financial regulators and stakeholders have rolled out an array of measures : regulators have established dedicated Fintech liaison platforms to enhance communications with the industry; HKMA introduced a Fintech Supervisory Sandbox and set up a Fintech Innovation Hub together with the Hong Kong Applied Science and Technology Research Institute, so as to support the industry in applying Fintech; apart from nurturing Fintech start-ups through its incubation programme, Cyberport also launched its dedicated Fintech co-

working space, Smart-Space FinTech, in late last year to provide 4 300 square meters for Fintech companies; InvestHK's dedicated Fintech team has also showcased Hong Kong's unique Fintech advantages through its inaugural Fintech Week held in November last year as well as the Fintech Finals 17 conference and start-ups competition held in January this year. We will continue to engage the industry to keep abreast of the dynamic Fintech landscape and its feedback on the various support measures, as well as further enhance our Fintech ecosystem and monitor any emerging opportunities and challenges on the international and local horizons.

21. Meanwhile, the Government commenced operation of the Payment Systems and Stored Value Facilities Ordinance in November last year. The implementation of the Ordinance helps ensure safe and robust operation of stored value facilities and retail payment systems, as well as adequate protection of users. HKMA will closely monitor technological and market development, and refine the regulatory regime as necessary in the light of its experience in regulating mobile payment services.

(g) *Financial Services Development Council ("FSDC")*

22. Over the past four years, the FSDC has drawn on the views of market experts to put forward an array of proposals on a number of subjects

concerning the financial services industry. The Government will actively consider and follow up on the recommendations from the FSDC. We will continue to provide resources to the FSDC as necessary and fully support its work, and also invite the Hong Kong Trade Development Council to collaborate with the FSDC and the industry to strengthen the promotion of our financial market and financial services industry outside Hong Kong.

Enhancing Market Infrastructure and Quality

(a) Assisting the newly established Insurance Authority in taking over existing functions of OCI

23. In December 2015, the independent Insurance Authority (“IIA”) was established and immediately renamed as the Provisional Insurance Authority to undertake essential preparatory work. According to the current progress, it is expected that IIA will be ready to take over the statutory functions of the Office of the Commissioner of Insurance in Q2 2017. We will put in place relevant pieces of subsidiary legislation on the collection of levy, authorisation fees and user fees to dovetail with the commencement of IIA’s regulatory work, and will continue to maintain close dialogue with the industry to ensure a smooth transition to the new regime.

(b) Legislation for policy holders' protection scheme

24. To more effectively protect insurance policy holders' interest and maintain market stability in the event of insurer insolvency, we propose to establish a Policy Holders' Protection Scheme as a safety net for policyholders. We are preparing the relevant legislation.

(c) Risk-based capital regime for the insurance industry

25. We announced the consultation conclusions on a risk-based capital regime for the Hong Kong insurance industry in September 2015 and stakeholders were in general support of the proposal. We have commenced the stage-two consultancy study to formulate detailed rules and will carry out quantitative impact studies to align Hong Kong's regulatory regime with international standards and make capital requirements more sensitive to the level of risk borne by insurance companies.

(d) Resolution regime for financial institutions

26. Enacted by LegCo in June last year, the Financial Institutions (Resolution) Ordinance (Cap. 628) ("FI(R)O") provides the legal basis for the establishment of a cross-sectoral resolution regime for financial institutions in

Hong Kong. The regime is in compliance with the prevailing international standards. Given the importance of certain financial arrangements to the functioning of the financial market, we are working on the regulations on protected arrangements under the FI(R)O to ensure that these financial arrangements are suitably protected in the resolution process to preserve their economic effects. We plan to introduce the regulations as subsidiary legislation under the FI(R)O into LegCo in the first half of 2017 such that the regulations could come into operation at the same time as the FI(R)O within this year.

(e) Enhancing protection for borrowers

27. To tackle money lending-related malpractices, the Government has introduced more stringent additional licensing conditions on money lender licences since December last year to better protect the public from being misled by such malpractices. Besides, a new public education campaign has commenced to raise public awareness of the new measures and provide gentle reminders to borrowers. We will also enhance public education on debt management. We will closely monitor the implementation of the new measures and the latest development of the money lending industry.

Enhancing the Mandatory Provident Fund (“MPF”) System

28. The Government and the Mandatory Provident Fund Schemes Authority (“MPFA”) has been working to reduce the level of fees and expenses of MPF funds. With various legislative and administrative measures taken by MPFA to enhance market transparency and scheme administration efficiency, as well as to promote market competition under the System in the past years, the average fund expense ratio (“FER”) of MPF funds has dropped from 2.06% in 2007 to 1.57% in December last year, representing a reduction of about 24%. Also, from the launch of the Employee Choice Arrangement up to the end of last year, 231 MPF funds have reduced fees, representing 48% of the total number of approved MPF funds. Since MPFA’s request for trustees to offer at least one “low-fee fund” (i.e. funds with management fees not higher than 1% or FER of 1.3% or below) under each MPF scheme, there were 172 “low-fee funds” under 32 MPF schemes up to the end of last year, representing about 42% of the total number of MPF funds currently available for selection in the MPF market.

29. To further facilitate scheme members in making MPF investment that fulfills the long term retirement savings objective and drive down MPF fees, we will implement the fee-controlled Default Investment Strategy (“DIS”) on 1 April this year. Trustees have informed scheme members about the implementation of the DIS. To ensure that MPF scheme members fully understand the DIS and its transitional arrangements, MPFA has rolled out a three-stage publicity and education campaign since June last year. It is

envisaged that the fee-controlled DIS will promote competition among MPF service providers on fees and fund performance. The Government and MPFA will review the DIS fee control within three years after the launch of the DIS.

THE TREASURY

International Tax Cooperation

30. As an international financial centre and a responsible member of the international community, Hong Kong has all along been supportive of the international efforts to enhance tax transparency and combat cross-border tax evasion.

31. In relation to automatic exchange of financial account information in tax matters (“AEOI”), we have put in place a legal framework for its implementation in Hong Kong, and signed agreements with Japan and the United Kingdom for conducting AEOI on a bilateral basis. This will enable Hong Kong to deliver its commitment to commence the first automatic exchanges in 2018. It is crucial for Hong Kong to demonstrate our commitment by

expanding our AEOI network with other tax jurisdictions. We have approached our tax treaty partners which are committed to adopting AEOI for the relevant discussions. The Government will also keep a close watch on the latest international developments relating to AEOI, and map out our strategy and response accordingly.

32. As regards the package to tackle base erosion and profit shifting (“BEPS”) of enterprises, Hong Kong indicated to the Organisation for Economic Co-operation and Development (“OECD”) in June 2016 its commitment to the response package and its consistent implementation. We are an Associate in the inclusive framework established by the OECD for implementing the BEPS package. To take forward our commitment, we conducted a consultation exercise in October to December last year to gauge stakeholders’ views on the implementation of the BEPS package in Hong Kong. We are analyzing the feedback received in formulating the way forward and drawing up the relevant legislative proposals. We aim to introduce the relevant amendment bill(s) into the Legislative Council in the second half of this year.

33. Besides, the Government will continue to expand Hong Kong’s

network of Comprehensive Avoidance of Double Taxation Agreements (“CDTAs”) with our trading partners. So far, Hong Kong has signed 36 CDTAs, including the latest one with Belarus signed earlier this month.

**Financial Services and the Treasury Bureau
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