立法會
Legislative Council

LC Paper No. CB(1)830/17-18
(These minutes have been seen by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of special meeting held on
Monday, 8 January 2018, at 9:00 am
in Conference Room 2 of the Legislative Council Complex

Members present : Hon Kenneth LEUNG (Chairman)
Hon Christopher CHEUNG Wah-fung, SBS, JP (Deputy Chairman)
Hon James TO Kun-sun
Hon Abraham SHEK Lai-him, GBS, JP
Hon Jeffrey LAM Kin-fung, GBS, JP
Hon WONG Ting-kwong, GBS, JP
Hon Starry LEE Wai-king, SBS, JP
Hon CHAN Kin-por, GBS, JP
Hon Paul TSE Wai-chun, JP
Hon WU Chi-wai, MH
Hon Charles Peter MOK, JP
Hon Dennis KWOK Wing-hang
Ir Dr Hon LO Wai-kwok, SBS, MH, JP
Hon Alvin YEUNG
Dr Hon Junius HO Kwan-yiu, JP
Hon Holden CHOW Ho-ding
Hon SHIU Ka-fai
Hon CHAN Chun-ying
Hon CHEUNG Kwok-kwan, JP

Member attending : Hon KWOK Wai-keung, JP

Members absent	**:**	Hon Mrs Regina IP LAU Suk-yee, GBS, JP Hon CHU Hoi-dick Hon LUK Chung-hung
Public officers attending	**:**	<u>Agenda Item I</u> Mr Paul MP CHAN, GBM, GBS, MH, JP Financial Secretary Mr Willy TSOI Administrative Assistant to Financial Secretary Mrs Helen CHAN, JP Government Economist <u>Agenda Item II</u> Mr Paul MP CHAN, GBM, GBS, MH, JP Financial Secretary Mr Willy TSOI Administrative Assistant to Financial Secretary Mr James LAU, JP Secretary for Financial Services and the Treasury Ms Alice LAU Yim, JP Permanent Secretary for Financial Services and the Treasury (Treasury) <u>Agenda Item III</u> Mr Andrew LAI, JP Deputy Secretary for Financial Services and the Treasury (Treasury)2 Mr CHIU Kwok-kit, JP Deputy Commissioner (Technical) Inland Revenue Department

Mr CHAN Sze-wai
Senior Assessor (Research)3
Inland Revenue Department

Agenda Item IV

Mr Andrew LAI, JP
Deputy Secretary for Financial Services and the Treasury (Treasury)2

Mr CHIU Kwok-kit, JP
Deputy Commissioner (Technical)
Inland Revenue Department

Mr CHAN Sze-wai
Senior Assessor (Research)3
Inland Revenue Department

Agenda Item V

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

Agenda Item VI

Mr Chris SUN, JP
Deputy Secretary for Financial Services and the Treasury (Financial Services)

Ms Eureka CHEUNG
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)

Ms Ada CHUNG, JP
Registrar of Companies

Attendance by Invitation : Agenda Item V

Mr John LEUNG, JP
Chief Executive Officer
Insurance Authority

Mr Raymond TAM
Executive Director (Policy and Development)
Insurance Authority

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

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I Briefing by the Financial Secretary on Hong Kong's latest overall economic situation

(LC Paper No. CB(1)207/17-18(01) — Third Quarter Economic Report 2017 and the press release

LC Paper No. CB(1)402/17-18(01) — Administration's paper on Hong Kong's recent economic situation and near-term outlook)

Briefing by the Administration

At the invitation of the Chairman, the Financial Secretary ("FS") briefed members on Hong Kong's latest overall economic situation.

(*Post-meeting note*: The press release containing the speaking note of FS (Chinese version only) was issued to members vide LC Paper No. CB(1)448/17-18(01) on 9 January 2018.)

2. The Government Economist ("G Econ") gave a powerpoint presentation on the latest developments in the Hong Kong economy, latest situation in the local

residential property market and the economic outlook of the local and global economy in 2018.

> (*Post-meeting note*: The notes of the powerpoint presentation (LC Paper No. CB(1)440/17-18(01)) were issued to members vide Lotus Notes email on 9 January 2018.)

Discussion

Labour market

3. Noting the current very low unemployment rate and the ageing working population in Hong Kong, Ir Dr LO Wai-kwok enquired about the Administration's measures to tackle the challenges in order to maintain Hong Kong's long-term competitiveness.

4. Mr SHIU Ka-fai expressed concern about the serious manpower shortage faced by many sectors including the retail sector, and urged the Administration to critically consider importing labour and expedite the relevant process as soon as possible.

5. FS advised that in order to tackle the tight manpower situation in Hong Kong, the Government had been developing measures including family-friendly employment policies with a view to attracting new entrants to the labour force, particularly females and housewives; and encouraging the use of innovation and technology to enhance productivity . As regards importation of labour, the Chief Executive's 2017 Policy Address had acknowledged labour shortage and recruitment difficulty faced by individual sectors. Besides discussing with the relevant sectors ways to enhance training and attract new recruits, the Government would also explore with stakeholders the possibility of increasing imported labour, for example for subsidized elderly service and rehabilitation service units on an appropriate and limited scale, under the premise that local workers' priority for employment and their level of wages would be safeguarded.

Property market

6. Ir Dr LO Wai-kwok expressed concerns about the continual surge in residential property prices in Hong Kong, the concentration of transactions in the first-hand market and the sluggish secondary market resulted from implementation of Government's various demand-side management measures.

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He asked whether the Administration would consider other measures to address the rising residential property prices.

7. Mr Jeffrey LAM was of the view that raising flat supply through increasing land supply would better ensure the healthy and stable development of the property market than implementing the demand-side management measures. He enquired about measures the Administration would take to increase land and housing supply including conversion of potential sites into disposed sites, to cool down the residential property market, and to help people achieve home ownership.

8. FS responded that in view of the overheated residential property market in recent years, the Government had introduced several rounds of demand-side management measures to combat short-term speculation, curb external demand and reduce investment demand in order to maintain the healthy and stable development of the residential property market. He considered that increasing housing supply would be the key to addressing the surge in residential property prices in the long run. As regards measures to increase land supply, FS pointed out that the Task Force on Land Supply appointed by the Chief Executive would examine various land supply options and planned to commence a public engagement exercise in the first half of 2018 to facilitate informed discussion of the community on the pros and cons of various options and the relative priorities in a thorough and macro manner, with a view to achieving the broadest consensus and mapping out the direction for land supply that would benefit the community as a whole. On the concern about the secondary property market, FS said that amendments had been made to the Stamp Duty (Amendment) Bill 2017 to extend the statutory time limit for disposal of the original property under the refund mechanism to allow more time for people replacing residential properties to sell their original properties.

9. Mr Dennis KWOK declared that he was a director of the Hong Kong Mortgage Corporation Limited. He expressed grave concern about the high residential property prices, and the disappointment of many young people in failing to own their own homes. He urged the Administration to study measures to assist young people to purchase residential properties, particularly to assist those who could not afford the down payment.

10. Mr Holden CHOW noted that based on the assumption of 70% loan-to-value ratio and mortgage tenor of 20 years, the housing affordability ratio had reached around 68% in the third quarter of 2017. With tightening mortgage policies of banks, prospective buyers had to arrange top-up loans (i.e. second mortgages) which might further worsen the housing affordability ratio. He asked

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whether the Administration would consider relaxing the loan-to-value ratio cap for residential mortgages so as to assist potential buyers who were capable of paying the mortgages but faced difficulty in making down payment. Mr Christopher CHEUNG asked if the Administration would consider relaxing the loan-to-value ratio cap for properties with a value below $4.5 million.

11. FS advised that the Government aimed to tackle the housing problem through increasing residential land supply and provision of more public and private housing. He was aware of the difficulties faced by young people in attaining home ownership. Measures to assist young people in acquiring their homes in the face of soaring property prices included the existing Home Ownership Scheme and the "Starter Homes" Pilot Scheme for Hong Kong Residents as proposed in the Policy Address. Moreover, the demand-supply balance in the residential property market would ease over time when the increased residential land supply over the past few years gradually turned into actual flat production. As at December 2017, the aggregate private housing land supply in 2017-2018 was estimated to have the capacity to provide about 24 300 flats, exceeding the annual supply target of 18 000 flats. The projected supply of first-hand residential flats in the coming three to four years would stay at a high level of 97 000 units as at end-September 2017. Subject to the actual construction progress, it was estimated that completion of private flats could reach about 20 000 units per year in the coming few years, higher than the past few years. Given that the interest rate normalization process in the United States ("US") would continue, the local interest rates were expected to rise eventually exerting pressure on the local residential property market. FS cautioned that it would be inappropriate for the Government to relax the existing loan-to-value ratio cap and the demand-side management measures at this stage lest this would send a wrong signal to members of the public and drive up property prices further. He added that the Government would continue to monitor the residential property market so as to identify a suitable juncture for adjusting the demand-side management measures.

12. As regards the housing affordability ratio, G Econ explained that the ratio was meant to be an indicator to track the changes in affordability of a typical flat for an average household over time and hence the housing market bubble risk. The housing affordability ratio was different from the debt servicing ratio published by the Hong Kong Monetary Authority ("HKMA"). The latter was the actual monthly repayment obligations of a borrower as a percentage of monthly income adopted by banks for assessing the repayment capability of the borrower. After implementation of several rounds of demand-side management measures, the debt servicing ratio had dropped to 34%.

13. In response to Mr WU Chi-wai's enquiry about the Administration's measures to curb external demand and reduce investment demand for residential properties, FS advised that imposing a 15% Buyer's Stamp Duty on all residential properties acquired by any person (including companies) except a Hong Kong permanent resident acting on his/her own behalf was one of such demand-side management measures introduced by the Government in 2012.

Macroeconomic conditions

14. Ir Dr LO Wai-kwok enquired how the Administration would maintain the financial stability of Hong Kong amid interest rates normalization in the US and other major economies. He was concerned that such process might trigger volatilities in the global financial markets and increase uncertainties in the global economic outlook.

15. Mr Jeffrey LAM expressed concern about the uncertainties associated with the US monetary policy normalization coupled with the tapering of monetary stimuli by the world's major central banks, which might affect global financial conditions and capital flows. He enquired how the Administration could maintain Hong Kong's competitiveness with the uncertainties ahead.

16. FS responded that with a view to further enhancing the competitiveness of the business environment of Hong Kong, the Government would soon introduce legislative proposals to implement a two-tiered profits tax rates system for enterprises under which the profits tax rate for the first $2 million of profits of enterprises would be lowered to 8.25%. The Government would closely monitor the impacts of the US interest rate normalization on the global economy. As regards the standard rate of profits tax, FS did not consider that the current circumstances warranted any change to the tax rate. That said, the Government would consider providing targeted tax incentives as one of the means to encourage the development of certain industries/sectors and to enhance Hong Kong's competitiveness.

17. Mr CHAN Chun-ying pointed out that while the US interest rate normalisation and tax reform might have negative impact on the local asset prices, the persistently weak US dollar to which the Hong Kong dollar was pegged might support the local asset prices and exert upward pressure on inflation. Against the above background, he sought the Administration's view on the movement in asset prices and inflation rate of Hong Kong in the coming year. Mr Holden CHOW also expressed concern on the US tax reform, in particular its impact on international capital flows.

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18. Mr WONG Ting-kwong said that the Hong Kong economy would continue to be surrounded by various external uncertainties including the increase in interest rate and volatile fund flows. He enquired about the Administration's plans to tackle such risks in 2018.

19. FS said that the global economy was expected to maintain moderate expansion in the near term. The Government would monitor the global economic developments and stay vigilant to various uncertainties in the external environment. In addition, the Government would continue to enhance Hong Kong's competitiveness through diversifying the economy. On the development of the innovation and technology industries, the Government would focus on promoting four key areas where Hong Kong had strength, namely artificial intelligence, financial technologies, smart city and biochemical technologies. The Government would also promote the use of innovation and technology in enhancing the competitiveness of various industries. Moreover, Hong Kong would continue to leverage its unique advantages to capitalize on the opportunities in the Mainland economic development and opening up, in particular those arising from the Belt and Road Initiative, the development of the Guangdong-Hong Kong-Macao Bay Area ("Bay Area") and various initiatives of the National 13th Five-Year Plan.

20. On the normalization of the US interest rate, FS said that the five US rate hikes since December 2015 had cumulated to an increase of 125 basis points. The Federal Reserve and the financial markets generally expected that the US would further increase interest rates by three times in 2018. FS cautioned that under the Linked Exchange Rate System, the local interest rates would eventually rise and this might impact on the local asset market. He added that the US tax reform might trigger shifts in global capital flows and responses from other major economies in the form of changes in their own tax systems. The Government would closely monitor these developments and their impacts on the global economy as well as the Hong Kong economy, and would consider appropriate policies and measures where necessary.

21. Mr SHIU Ka-fai expressed concern that despite the upward trend of retail sales volume in recent months, the prospect of the retail industry might be dim with the recent reduction in the import duty by the Mainland.

22. FS considered that insufficient retail shop space had led to increase in sale prices and shop rentals, and an increase in land supply would help address the problem. The Government was aware of the need to enhance Hong Kong's appeal to tourists especially those with high spending power. Good performance of the local economy would also boost domestic demand and support the retail business.

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23. Mr Alvin YEUNG expressed concern on the high level of local government debts in the Mainland which could pose risk to the financial stability of Hong Kong. He enquired if the Administration had measures in place to counter possible risks on the Hong Kong's banking sector.

24. G Econ responded that according to the International Monetary Fund, the total government debts, including local government debts, in the Mainland was around 62% as a ratio to its Gross Domestic Product, not a particularly high level when compared internationally. The Central People's Government ("CPG") had put great emphasis to contain and address risks associated with local government debts, and had been enhancing regulation of shadow banking activities in recent years. It was noted that the contribution of shadow banking activities to the growth in total social financing in the Mainland had reduced significantly in recent years. FS supplemented that HKMA had set stringent underwriting standards on banks' exposure to Mainland-related lending, thus ensuring the quality of such lending. In fact, most of these lendings were backed by collateral or guarantee . The ratio of non-performing loans of banks in Hong Kong had all along remained low at below 1%.

25. Mr Christopher CHEUNG said that the Hong Kong stock market experienced great rallies since late 2017 and asked how the Government would manage the heightened risks and enhance protection of retail investors.

26. FS advised that the Government had been working closely with HKMA, the Securities and Futures Commission and the Hong Kong Exchanges and Clearing Limited to ensure the effective and orderly operation of the stock market, and managing the risks in a prudent manner. Besides monitoring changes in the stock market indices and the transaction volumes, the Government would also examine matters such as the short-selling position of shares and developments in the derivatives market with a view to maintaining the financial stability of Hong Kong.

(At 10:28 am, the Chairman ordered that the meeting be suspended for 3 minutes. The meeting resumed at 10:32 am.)

II 2018-19 Budget Consultation

(LC Paper No. CB(1)402/17-18(02) — Information pack for the Financial Secretary's consultations on the 2018-2019 Budget)

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Briefing by the Administration

27. FS said that the Government would announce the 2018-2019 Budget on 28 February 2018 and the relevant consultation work began in December 2017. When preparing the 2018-2019 Budget, he would make available resources for the policy initiatives announced in the Chief Executive's 2017 Policy Address. In view of the long-term fiscal challenges ahead, in particular the fiscal pressure arising from an ageing population, the Government would continue to adhere to the principle of prudent management of public finances. To facilitate sustainable development of the economy essential to Hong Kong's long-term fiscal health, the Government would work to address the bottlenecks in insufficient land supply and labour shortage in certain industries, continue to promote diversified development of the economy, identify new growth areas, and create more quality jobs for young people. Moreover, Hong Kong should also seize the opportunities arising from the Belt and Road Initiative, the development of the Bay Area and the National 13th Five-Year Plan. The Government would carefully consider the views of Members and the public in preparing the 2018-2019 Budget.

> (*Post-meeting note*: The press release containing the speaking note of FS (Chinese version only) was issued to members vide LC Paper No. CB(1)448/17-18(02) on 9 January 2018.)

Discussion

Managing the public finance

28. Mr CHAN Chun-ying noted that the Government would strive to achieve fiscal balance over a period of time instead of every year. He also noted that as of November 2017, the fiscal reserves were equivalent to 25 months of government expenditure. He enquired about the principles adopted by the Government in managing public finance and whether FS would consider setting a target on the level of the fiscal reserves so that the Government could make use of the annual surplus in a more flexible manner.

29. FS said that it would be more practicable to achieve fiscal balance over a period of time (e.g. an economic cycle) and the Government also needed to maintain sufficient reserves for implementing countercyclical measures during an economic downturn. As regards the fiscal reserves, FS said that the Government would make use of the annual surplus flexibly according to needs and the economic condition, and did not intend to set a target level. FS cautioned that setting a target level on the fiscal reserves arbitrarily might also attract criticism from international credit rating agencies.

30. Mr CHAN Kin-por was supportive of the Government's new fiscal philosophy which he considered could accumulate surpluses for the benefit of the whole community. He emphasized the importance of making timely investments as preventive measures, such as investing in preventive medical care and facilitating ageing in place, which would in turn reduce the Government's expenditure on medical and elderly services in the future.

31. FS agreed with Mr CHAN's view and remarked that the Government would invest more proactively so as to generate continuous revenues and enable it to make further investments for the benefit of the community in future.

Tax related issues

32. Mr CHAN Chun-ying opined that the Administration should consider introducing vacant residential property tax in Hong Kong in order to widen the tax base and raise government revenue.

33. Mr Dennis KWOK enquired whether the Administration would consider introducing capital gains tax on properties, especially those owned by non-Hong Kong residents, with a view to curb the soaring property prices.

34. FS advised that one of the priorities of this Government was to introduce tax initiatives to promote economic development of Hong Kong. Agreeing that the current tax base was narrow, the Government would examine the pros and cons of introducing vacant residential property tax and capital gains tax on properties very carefully.

35. Mr CHAN Kin-por was of the view that the Government should consider offering special tax concessions to large corporates or enterprises which could create abundant employment opportunities and generate huge economic benefits for Hong Kong.

36. FS said that the Government would explore ways to enhance Hong Kong's competitiveness in various aspects, including promoting the development of the innovation and technology industries and introducing appropriate tax incentives. He added that it was also important to devise policies to attract leading companies to set up businesses in Hong Kong.

Use of budget surplus

37. In view of the abundant fiscal surpluses available, Mr CHAN Chun-ying suggested that the Administration should consider establishing a sovereign fund

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for making diversified and long-term investments with a view to providing the Government with more resources and room to cope with the future challenges.

38. FS said that part of the fiscal reserves was currently placed with the Long-Term Growth Portfolio ("LTGP") of the Exchange Fund managed by HKMA as long-term investments. The sum of such long-term investments had reached more than HK$100 billion, and the Government was exploring with HKMA the feasibility of further increasing the amount of such long-term investments gradually having regard to relevant factors including market conditions and investment opportunities. He added that the investment return of LTGP had been satisfactory, with annualized internal rate of return exceeding 10% since inception.

39. Mr WU Chi-wai pointed out that an ageing population was expected to increase significantly the demand for residential care homes for the elderly ("RCH"). He considered that the Government should earmark resources in the budget surplus for the development of RCH to meet the future needs. He further noted that the Government had reserved a provision of $200 billion in 2016 for implementing the 10-year hospital development plan and opined that the Government should consider increasing the amount of funding to cater for rising construction costs. Moreover, he suggested that the Government should set up a seed fund to help employers meeting the expenses on severance payment ("SP") and long service payment ("LSP") after the abolition of the offsetting arrangement under the Mandatory Provident Fund ("MPF") system.

40. FS explained that in considering the deployment of the annual surplus and ensuring optimal allocation of resources, the Government need to take into account the source and nature of the surplus, the prevailing economic situations and external environment as well as the future needs of society and public aspirations. He said that the $30 billion earmarked from the annual surplus in 2016-2017 for strengthening elderly services and rehabilitation services could be used for the development of RCH. Where necessary, the Government would consider increasing the resources for elderly services, rehabilitation services and the hospital development plan. As regards the abolition of the MPF offsetting arrangement, FS advised that the Government was willing to enhance its financial commitment to help employers adapt to the policy change of abolishing the offsetting arrangement but the Government's expenses should be finite and time-limited. The Government would earmark necessary funding after a consensus on the abolition arrangement had been reached.

41. The Chairman enquired about the details of the funding arrangements of the 10-year hospital development plan and the Housing Reserve providing

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resources to the Housing Authority ("HA") for meeting the 10-year public housing supply target. He further urged the Administration to increase resources to promote the development of environmental protection-related projects/businesses in Hong Kong.

42. FS took note of the Chairman's suggestion. He advised that some $77 billion had been set aside as the Housing Reserve and was placed with the Exchange Fund for investment purposes. The Housing Reserve and the investment returns generated would be used to fund the public housing development programmes and related infrastructure projects. After the Government and HA had reached agreement on the amount and timetable of funding injection, the Government would seek approval of the Finance Committee of the Legislative Council ("LegCo") for deploying the Housing Reserve to support public housing development. As regards the 10-year hospital development plan, FS said that a dedicated provision of $200 billion had been set aside to expand and upgrade healthcare facilities in a more flexible and long-term manner. He added that the Government would be willing to allocate additional resources for environmental protection subject to detailed recommendation of the relevant bureaux.

43. Noting that the expenditure for social welfare, health and education accounted for around 60% of the total expenditure of the Government, Mr Alvin YEUNG asked whether the Administration had considered setting up special funds with a view to accumulating substantial amount of surpluses to fund these expenditure items so as to ensure the service level could be maintained even in times of economic downturn.

44. FS explained that vast majority of the expenditure in social welfare, health and education was recurrent in nature and would be funded by the fiscal reserves in times of economic downturn. In general, the Government would only consider setting up special funds for financing projects of a capital nature to ensure sufficient funding for their implementation.

45. Ms Starry LEE highlighted the financial burden of the middle class and grass-root people. She said that high property prices and high rentals were the major reasons leading to the very high living cost in Hong Kong. She asked what measures the Administration would take to address the needs of the middle class and grass-root people, in particular their aspirations of home ownership.

46. FS responded that the Government aimed to tackle the housing problem through increasing land supply and enhancing the provision of subsidized housing. The Government would also promote the development of innovative

and creative industries with a view to facilitating diversified development of the economy and creating more quality jobs for young people.

Measures to enhance Hong Kong's competitiveness

47. Mr Dennis KWOK was of the view that the Government should promote the development of professional services in Hong Kong, such as legal and accounting services. He suggested that the Administration should review the Partnership Ordinance (Cap. 38) with a view to facilitating privately offered funds to domicile in Hong Kong. He also pointed out that many Mainland enterprises encountered problem of corporate debts and the Administration should develop measures to attract those enterprises to engage professional services in Hong Kong for making debt restructuring arrangements.

48. FS advised that legislative reviews in relation to limited liability partnership and corporate insolvency were already included in the Government's work plan.

Promoting the development of financial services industry in Hong Kong

49. Mr Christopher CHEUNG enquired about the Administration's measures to promote the development of the local securities market, in particular if the Administration would step up efforts in discussing with the relevant authorities in the Mainland to expedite the progress of two-way mutual access in the financial markets in Hong Kong and the Mainland including the introduction of Southbound Trading of Bond Connect, Exchange Traded Fund Connect and Primary Equity Connect. Pointing out that the expeditious launch of the Primary Equity Connect in Hong Kong was a prime concern of the local brokerage industry, he enquired about the Administration's considerations in introducing this initiative in Hong Kong.

50. FS advised that besides Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect, the implementation of the mutual recognition of funds arrangement in 2015 was also a key milestone in the mutual capital market access between Hong Kong and the Mainland. As regards Primary Equity Connect, FS said that as considerable efforts would be required to effectively address the regulatory and operational concerns raised in both the Mainland and Hong Kong markets, it was expected that more time would be required for studying the Primary Equity Connect proposal. The Government would continue to enhance the breadth and depth of mutual financial market access between Hong Kong and the Mainland to strengthen Hong Kong's position as an international financial centre.

51. The Chairman enquired about the Administration's plan to regulate the online transactions of Bitcoin and the relevant implementation timetable.

52. The Secretary for Financial Services and the Treasury said that Bitcoin was regarded a commodity generated in the cyber world, and was neither a currency nor an electronic money and hence was not subject to the existing financial regulation in Hong Kong. That said, the Government would closely monitor international development in this area, including the relevant work of the International Organization of Securities Commissions, in deciding whether further measures were necessary especially on the front of anti-money laundering.

III Application of Multilateral Convention on Mutual Administrative Assistance in Tax Matters in Hong Kong

(LC Paper No. CB(1)402/17-18(03) — Administration's paper on "Application of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters in Hong Kong"

LC Paper No. CB(1)402/17-18(04) — Background brief on application of Multilateral Convention on Mutual Administrative Assistance in Tax Matters in Hong Kong prepared by the Legislative Council Secretariat)

Briefing by the Administration

53. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Treasury)2 ("DS(Tsy)2") briefed members of the upcoming key steps in extending the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ("Multilateral Convention") to Hong Kong. He pointed out that it was essential for Hong Kong to participate in the Multilateral Convention as it was one of the assessment criteria adopted by the Organisation for Economic Co-operation and Development ("OECD") and the European Union ("EU") in identifying "non-cooperative tax jurisdictions" in respect of tax transparency. To extend the Multilateral Convention to Hong Kong, the Government had introduced the Inland Revenue (Amendment)

(No.5) Bill 2017 to provide for a legal framework for Hong Kong to implement multilateral tax arrangements. The Government would seek the assistance of CPG in making a declaration to OECD that the application of the Multilateral Convention be extended to Hong Kong, and recommend the Chief Executive-in-Council ("CE-in-C") to make an order to declare that the Multilateral Convention shall have effect in Hong Kong. The Government would then sign the respective Multilateral Competent Authority Agreements ("MCAAs") to effect the implementation of automatic exchange of financial account information in tax matters ("AEOI") and automatic exchange of Country-by-Country reports (an initiative under the base erosion and profit shifting ("BEPS") package) on a multilateral basis under the Multilateral Convention.

Discussion

54. Pointing out that Hong Kong had already signed Comprehensive Avoidance of Double Taxation Agreements ("CDTAs") with a number of jurisdictions which had provided an exchange of information ("EOI") mechanism and adopted a bilateral approach in implementing AEOI by signing Tax Information Exchange Agreements ("TIEAs") with other jurisdictions, the Chairman enquired about the need for Hong Kong to join the Multilateral Convention and the possible consequence if Hong Kong did not participate in the Multilateral Convention.

55. DS(Tsy)2 advised that Hong Kong had taken a bilateral approach in tax treaty negotiations and so far signed 38 CDTAs and seven TIEAs for implementing EOI on tax matters with other jurisdictions. However the international community had been putting emphasis on a wide network of AEOI, in particular EU required arrangements be put in place for AEOI with all EU Member States. In the absence of a wide network for tax information exchanges, it was essential for Hong Kong to participate in the Multilateral Convention which would provide a platform for Hong Kong to conduct AEOI on a multilateral basis. He further said that both OECD and EU had kicked off their respective exercises to draw up lists of "non-cooperative tax jurisdictions", and one of the listing criteria was the progress and the network of implementing AEOI. Hong Kong might face a risk of not meeting the relevant assessment criteria of OECD and EU in the absence of a wide AEOI network and for not being a participant in the Multilateral Convention by September 2018 when the first exchange of AEOI would take place.

56. In response to the Chairman's enquiry regarding how participants in the Multilateral Convention would conduct exchanges of tax information, DS(Tsy)2

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said that Hong Kong would need to sign the MCAA for AEOI and activate exchange relationship with appropriate and interested partners (i.e. the 75 jurisdictions included as Hong Kong's reportable jurisdictions under Schedule 17E to the Inland Revenue Ordinance (Cap. 112)) before AEOI on a multilateral basis could take place. It would be necessary to introduce amendments to Schedule 17E to IRO if a participating jurisdiction of the Multilateral Convention, other than the 75 reportable jurisdictions, requested to conduct AEOI with Hong Kong in order to mandate reporting financial institutions in Hong Kong to collect and report relevant information of the foreign tax residents concerned to the Inland Revenue Department ("IRD").

57. Noting that the Government needed to take steps to extend the Multilateral Convention to Hong Kong, Mr Holden CHOW asked if such steps were different from those for giving effect to signed CDTAs in Hong Kong.

58. DS(Tsy)2 said that both CDTAs and the Multilateral Convention would be given effect in Hong Kong by orders made by CE-in-C under section 49 of IRO. Such orders were subsidiary legislation subject to negative vetting by LegCo. He pointed out that the existing IRO only empowered CE-in-C to make orders to give effect to arrangements made with the government of any territory outside Hong Kong for the purposes of affording relief from double taxation or exchanging information in relation to any tax imposed by the laws of Hong Kong or the territory concerned. Hence the Government had introduced the Inland Revenue (Amendment) (No. 5) Bill into LegCo to empower CE-in-C to declare by order that any tax arrangements having been made by Hong Kong with more than one government of any territories outside Hong Kong, or having been made by CPG and applied to Hong Kong, shall have effect. In response to Mr Holden CHOW's further enquiry, DS(Tsy)2 advised that should Hong Kong participate in any other multilateral tax cooperation agreements in the future, the Government would similarly make an order under section 49 of IRO to give effect to such agreements, and the order would be subject to negative vetting by LegCo.

IV Proposed creation of a Chief Assessor post in the Inland Revenue Department

(LC Paper No. CB(1)402/17-18(05) — Administration's paper on "Proposed Creation of a Chief Assessor Post in the Inland Revenue Department")

Briefing by the Administration

59. At the invitation of the Chairman, DS(Tsy)2 briefed members on the Government's proposal to create a permanent Chief Assessor post (to be designated as Chief Assessor (Tax Treaty)2 ("CA(TT)2")) in the Tax Treaty Section ("the TT Section") of IRD. He said that OECD had put forward new initiatives to enhance tax transparency and combat cross-border tax evasion including the common reporting standard for AEOI and the measures to combat BEPS. In taking forward these initiatives, there would be a tremendous increase in the workload of the TT Section. As the TT Section was currently led by only one Chief Assessor (currently designated as Chief Assessor (Tax Treaty) ("CA(TT)")), the Government considered it necessary to expand the Section and strengthen its directorate support to cope with the additional workload. Hence it was proposed to create another permanent post of CA.

Discussion

60. The Chairman enquired about the major tasks of the TT Section in the near future. Noting that one of the main duties of the proposed CA(TT)2 post was to represent Hong Kong at meetings on international tax cooperation, he enquired about the role of CA(TT)2 in conducting discussions and negotiations on tax matters with authorities of other jurisdictions and whether more senior officials would participate in such work.

61. Deputy Commissioner of Inland Revenue (Technical) ("DCIR(T)") responded that OECD would review Hong Kong's implementation of AEOI and the statutory dispute resolution mechanism under the BEPS package in 2020 and late 2018 respectively. Extra directorate support would be needed to oversee the review process and ensure effective implementation of the relevant measures including setting up the AEOI Portal to facilitate financial institutions to furnish returns and notifications for AEOI purposes. Other tasks of the TT Section included handling matters arising from automatic exchange of country-by-country reports and resolving disputes with treaty partners through Mutual Agreement Procedure. To handle the two tasks, three new Senior Assessor posts would be created in the TT Section in addition to the proposed CA(TT)2 post. As regards the negotiation work, they were mainly headed by DCIR(T) with the assistance of CA(TT). Besides, Senior Assessors of the TT Section and colleagues from the Department of Justice would also assist where appropriate. Creation of the proposed CA(TT)2 post would provide the much needed support in strategic planning and detailed research on the tax systems and tax treaty policies of the negotiation partners, which was key to success in negotiations.

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62. Mr Holden CHOW expressed support for the staffing proposal. He and the Chairman further suggested that the Administration should consider creating more directorate posts in the TT Section to cope with the increasing workload.

63. DCIR(T) said that the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") under OECD had put in place a "Staged Approach" to monitor the implementation of the AEOI standards by jurisdictions. In order to present a comprehensive picture of Hong Kong's implementation of international tax initiatives, it was necessary for IRD to enhance the manpower resources to support the relevant preparatory work. There was an urgent need to create the proposed CA(TT)2 post.

Conclusion

64. The Chairman concluded that Panel members had no objection to the Government submitting the proposal to the Establishment Subcommittee.

V Risk-based Capital Regime for the insurance industry of Hong Kong

(LC Paper No. CB(1)402/17-18(06)	—	Administration's paper on "Risk-based Capital Regime for the Insurance Industry of Hong Kong"
LC Paper No. FS02/17-18	—	Fact sheet on "Risk-based capital regime for the insurance industry of Hong Kong" prepared by the Research Office of Legislative Council Secretariat)

65. The Chairman said that a submission of the Hong Kong Federation of Insurers ("HKFI") relayed by Mr CHAN Kin-por was tabled for members' information.

(*Post-meeting note:* HKFI's submission was issued to members vide LC Paper No. 441/17-18(01) on 8 January 2018.)

Action

Briefing by the Administration

66. At the invitation of the Chairman, Deputy Secretary for Financial Services and the Treasury (Financial Services)2 ("DS(FS)2") briefed members on the development of a Risk-based Capital ("RBC") regime for the insurance industry in Hong Kong through a powerpoint presentation. He pointed out that RBC regime aimed to enhance the existing rule-based capital adequacy regime by taking risk factors pertinent to an individual insurer into account. In formulating the proposed RBC regime, the Government had made reference to the Insurance Core Principles relating to capital adequacy requirements issued by the International Association of Insurance Supervisors ("IAIS"). Similar to the practices of other jurisdictions, the proposed RBC regime comprised three pillars representing requirements for quantitative assessment aspects (Pillar 1), corporate governance and enterprise risk management aspects (Pillar 2) and disclosures (Pillar 3). On the implementation timetable, DS(FS)2 advised that the proposed RBC regime was being implemented in four phases. For Phase I, an RBC conceptual framework had been developed. For Phase II, which was the current stage, the Insurance Authority ("IA") was developing detailed rules and conducting Quantitative Impact Study ("QIS") exercises. The first QIS was launched on 28 July 2017. IA would also conduct public consultation on the draft rules of RBC regime, tentatively in 2020. For Phase III, the Government's current target was to introduce the relevant legislative amendments to LegCo in 2020-2021. For Phase IV, a sufficiently long run-in period would be provided for the implementation of RBC regime to facilitate migration of insurers to the new regime. DS(FS)2 added that having regard to the fact that there were currently 159 insurers of various sizes in Hong Kong, the Government and IA had been consulting the industry on the details of the framework carefully to refrain from over-regulation. Four Industry Focus Groups ("IFGs") involving representatives from HKFI and the Actuarial Society of Hong Kong had been set up and held 23 meetings to discuss various technical issues. The Government and IA would continue to engage the industry, professional bodies and other stakeholders throughout the development of the detailed rules.

(*Post-meeting note*: The powerpoint presentation materials (LC Paper No. CB(1)440/17-18(02)) were issued to Members vide Lotus Notes e-mail on 8 January 2018.)

Discussion

Implementation approach of the Risk-based Capital regime

67. Mr CHAN Kin-por highlighted the major issues set out in HKFI's submission. He said that while HKFI supported in principle the implementation

of RBC regime, it considered that the Administration should strike a proper balance between protecting policyholders and minimizing compliance costs of insurers. HKFI also suggested that the Administration should, apart from complying with the requirements of IAIS, make reference to the practices of other relevant jurisdictions in Asia including the Mainland and Singapore in implementing RBC regime with a view to maintaining the competitiveness of the Hong Kong's insurance industry. The Administration and IA should also continue to consult the views of the industry through IFGs. Mr CHAN called on IA to maintain close liaison with the industry, and pay heed to the needs of small and medium-sized insurers.

68. Mr Holden CHOW concurred with the views of Mr CHAN Kin-por that the Administration and IA should have regard to the needs of small-sized insurers in implementing RBC regime commensurate to the needs of policyholders protection so as to avoid a surge in their compliance costs.

69. DS(FS)2 said that the Government had no in-principle objection to the views raised by HKFI in its submission. He also assured members that the Government and IA would continue to liaise with the industry and consider the needs of small and medium-sized insurers to ensure that implementation of RBC regime could achieve a win-win situation for both policyholders and insurers. He reiterated that RBC regime contained a number of key requirements, one of which was the Pillar 2 requirement for insurers to conduct Own Risk and Solvency Assessment ("ORSA") to ensure that governing boards of the insurers were fully aware of the risks faced by the companies, hence would take corresponding actions to manage the risks effectively. On minimizing the compliance costs of insurers, DS(FS)2 pointed out that the Government and IA would observe the principle of proportionality, as suggested by IAIS, in formulating requirements under RBC regime. Chief Executive Officer, Insurance Authority ("CEO/IA") supplemented that IA would implement RBC regime through a pragmatic approach, and make reference to the requirements of IAIS and the practices of other jurisdictions such as EU, the Mainland, Singapore, Australia and Switzerland. IA would also continue to gauge the views of the industry through IFGs.

Implementation of Pillar 2 requirements under the Risk-based Capital regime

70. Mr CHAN Kin-por relayed HKFI's suggestion that IA should fully consult the industry before implementing Pillar 2 requirements of RBC regime, and prescribe a reasonable implementation timetable. CEO/IA advised that IA aimed to conduct public consultation on the draft new guideline regarding enterprise risk management and ORSA (which were the major Pillar 2

requirements) in early 2018, with a view to issuing the new guideline by end 2018. It was envisaged that relevant measures would be implemented in phases starting from 2020.

VI Creation of a permanent directorate post in the Companies Registry

(LC Paper No. CB(1)402/17-18(07) — Administration's paper on "Proposed Creation of a Permanent Directorate Post in the Companies Registry")

Briefing by the Administration

71. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Financial Services) ("DS(FS)") briefed members on the Government's proposal to create a permanent directorate post of Registry Manager ("RM") in the Companies Registry ("CR"). He explained that the Government introduced the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017 ("the Bill") into LegCo in June 2017 to enhance the anti-money laundering and counter-terrorist financing ("AML/CTF") regulation of designated non-financial businesses and professions ("DNFBPs") to apply the statutory customer due diligence ("CDD") and record-keeping requirements to four sectors of DNFBPs including trust or company service providers ("TCSPs"). A new licensing regime for TCSPs would be introduced to require them to apply for licences from the Registrar of Companies and satisfy a fit-and-proper test before they could provide trust or company services as a business in Hong Kong. To take on the new regulatory role in respect of TCSPs, the Government proposed to set up a new TCSP Registry under CR ("the TCSP Registry") to be headed by the proposed RM post.

72. The Registrar of Companies supplemented that the proposed RM post would be responsible for the overall management and daily operation of the TCSP Registry including accommodation matters, designing procedures for processing new/renewal applications under the licensing regime, manpower planning, setting up and maintaining an information technology system to facilitate operation, and developing guidelines for compliance by TCSP licensees. Besides, the proposed RM post would also support the Registrar of Companies in their contribution to the mutual evaluation of the AML/CTF regime of Hong Kong conducted by the Financial Action Task Force ("FATF") in 2018.

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Discussion

73. Noting that the proposed RM post would be supported by a team of 59 non-directorate staff, Mr CHAN Kin-por asked how the estimated manpower had been worked out.

74. The Registrar of Companies explained that the required manpower had been worked out taking into account the estimated workload of the TCSP Registry. She pointed out some of the manpower would be involved in handling applications for TCSP licences. It was envisaged that there would be a caseload of around 10 000 applications for TCSP licences, involving 7 500 applications from corporations and 2 500 from individuals. Upon receipt of an application for TCSP licence, the Registrar of Companies had to determine if the applicant was a fit and proper person for carrying on trust or company services business in Hong Kong and to arrive at a decision within a reasonable timeframe. In addition to the licensing work, the TCSP Registry had to take enforcement measures such as carry out on-site inspections, and implement publicity measures for the new TCSP licensing regime. DS(FS) added that the required manpower had been proposed having regard to the practical need of the TCSP Registry and the need to deploy public resources in a prudent manner.

75. Mr Holden CHOW cautioned that the TCSP Registry should refrain from taking excessive enforcement against TCSPs so as to minimize the compliance costs on the TCSP sector. He also enquired whether the TCSP Registry would put in place a mechanism to handle appeals against decisions rejecting applications for TCSP licences.

(At 12:42 pm, the Chairman said that he would extend the meeting to 1:00 pm.)

76. The Registrar of Companies pointed out that the new regulatory regime was proposed having regard to the requirement set by FATF. In checking the compliance of TCSP licensees, the TCSP Registry would focus on licensees' compliance with the statutory CDD and record-keeping requirements rather than the daily operation of TCPS licensees. Enforcement actions would be conducted in a balanced approach so as to minimize regulatory burden and compliance cost on the licensees while ensuring that they were compliant. As regards the appeal mechanism, DS(FS) responded that the Bill proposed to change the name and ambit of the existing tribunal to also handle appeals against the Registrar of Companies's decisions in relation to applications for TCSP licence.

77. In response to Mr Holden CHOW's enquiry about allowing DNFBPs to rely on third parties to carry out CDD measures, DS(FS) said that the Government

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had taken on board the views of the Bills Committee on the Bill and would introduce amendments to the Bill to this effect when the Bill resumed the Second Reading debate at LegCo.

Conclusion

78. The Chairman concluded that Panel members supported the Government submitting the proposal to the Establishment Subcommittee.

VII Any other business

79. There being no other business, the meeting ended at 12:50 pm.

Council Business Division 1
Legislative Council Secretariat
18 April 2018