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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. Being an important pillar of the Hong Kong economy, the financial services industry contributed to about one-sixth of our Gross Domestic Product, providing about 250 000 jobs which accounted for over 6% of the working population. Hong Kong's position as the world's financial centre is also widely recognised. Hong Kong ranked third in Global Financial Centres Index released in September this year, just behind London and New York. In the World Competitiveness Yearbook 2017 published by the Institute for Management Development in Lausanne of Switzerland in May this year, Hong Kong was again ranked the world's most competitive economy for the second consecutive year, it also topped the ranking in finance efficiency.

3. The Government and regulators will continue to stay vigilant amidst the potential volatility in the global financial markets. While the United States Federal Reserve is normalising its monetary policy, the European Central Bank has yet to decide whether to reduce the scale of its quantitative easing. The monetary environment and capital flow is therefore still highly unpredictable. The evolving development of Brexit would also add uncertainties to the global geopolitical and economic outlook.

4. We will closely monitor the latest development of the global and local financial markets, enhance exchanges among regulators to ensure the proper functioning of our financial system. To reinforce and enhance Hong Kong's status as an international financial centre, a global offshore Renminbi business hub and an international asset management centre, we will capitalise on the opportunities arising from the Belt and Road Initiative and the Bay Area and make the best use of Hong Kong's advantages to promote diversified development of our financial market. 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.

New Initiatives

(a) *Financial Leaders Forum*

5. The Financial Leaders Forum chaired by the Financial Secretary has been set up as a platform to deliberate on strategic and forward-looking proposals that are conducive to strengthening Hong Kong’s position as an international financial centre, and to keep track of the progress in implementing such proposals by Government departments and other relevant organisations, with a view to enhancing monetary stability, financial safety and market quality.

(b) *Financial Services Development Council (“FSDC”)*

6. Since its establishment, the FSDC has been dedicated to advising the Government on the sustained development of Hong Kong's financial services industry. Apart from research work, the FSDC has been actively promoting Hong Kong's financial services industry in the Mainland and overseas through participating in a wide range of marketing campaigns, and assisting in nurturing human capital in the industry. The Government will allocate more resources to the FSDC to enhance its role in conducting strategic research, formulating recommendations, promoting market development and nurturing talent, with a view to enhancing Hong Kong's competitiveness in the international financial

market. To allow the FSDC to carry out its functions more effectively and to enhance its operational efficiency and flexibility, the Government plans to incorporate the FSDC as an independent organisation. We will consult the Panel on Financial Affairs on the long-term institutional set-up and funding arrangement of the FSDC in November this year.

(c) *Implementing the latest international standards on banking regulation*

7. Maintaining financial stability is vital to the development of Hong Kong as an international financial centre. We will continue to implement regulatory standards prescribed by international organisations such as the Basel Committee on Banking Supervision and the Financial Stability Board, with a view to ensuring the resilience of the financial system. We will introduce the Banking (Amendment) Bill 2017 into the Legislative Council ("LegCo") later this month to implement the latest international standards on recovery planning and financial exposures limits, with a view to strengthening the banking sector's ability to absorb shocks arising from financial and economic stress in the future.

(d) *Auditor Regulatory Reform*

8. The Government will amend the relevant legislation to improve the existing regulatory regime for listed entity auditors, such that the regime will be independent from the audit profession and its disciplinary mechanism can be strengthened. This will help ensure the regime is benchmarked against the international standard and practice, and maintain the confidence of investors in Hong Kong's overall financial regulatory regime with regard to the capital market. We will introduce the amendment bill into LegCo in the fourth quarter this year.

(e) *Risk-based capital regime for the insurance industry*

9. We have completed the stage-two consultancy study on a risk-based capital regime 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. The Insurance Authority ("IA") is carrying out quantitative impact studies to determine the parameters of the framework. The IA will proceed to consult the industry on the key legislative proposal towards the end of this year.

(f) *Policy Holders' Protection Scheme*

10. To protect insurance policy holders' interest and maintain market stability in the event of insurer insolvency, we propose to establish a Policy Holders' Protection Scheme to provide policy holders with a safety net, so as to boost public confidence in the insurance sector. We are preparing the relevant legislation and our target is to introduce the bill into LegCo in the second half of 2018.

(g) Financial Technologies (Fintech)

11. We encourage financial institutions in Hong Kong to make use of Fintech to raise operational efficiency, as well as to enhance the experience of customers in financial services. To facilitate innovations in Fintech, the Hong Kong Monetary Authority ("HKMA"), the Securities and Futures Commission ("SFC") and the IA announced their respective new initiatives on supervisory sandboxes in September this year. These would help expedite the launch of new Fintech products and services to the market. Meanwhile, to further promote the development of payment market, the HKMA is developing a "Faster Payment System", which is expected to be completed next year. The Government will also actively promote the use of new payment channels (such as smartphone e-wallet) for various Government fees and charges to complement the development of the industry and offer convenience to the public.

12. We note an increase in the use of Initial Coin Offerings ("ICOs") to raise funds. The SFC published a statement in September this year to explain that, depending on the facts and circumstances of an ICO, digital tokens that are offered or sold may be "securities" as defined in the Securities and Futures Ordinance, and accordingly subject to the securities laws of Hong Kong. We will closely monitor the situation, having regard to the developments of ICOs in other jurisdictions.

(h) *Government green bond*

13. As an international financial centre, Hong Kong possesses a sound legal and regulatory system, a mature capital market with first-class financial infrastructure, and a wealth of financial intermediaries and talents, which stand us in good stead to develop green finance. To demonstrate our support for sustainable development and determination to combat climate change, and to promote the development of green finance in Hong Kong, the Government will take the lead in arranging the issuance of a green bond in the 2018/19 financial year. Through this initiative, we seek to encourage investors in the Mainland and along the Belt and Road as well as international investors to arrange financing of their green projects through our capital markets. With our encouragement, the Airport Authority Hong Kong has announced the issuance of a green bond in Hong Kong. We will continue to encourage public sector

bodies to follow suit and promote the establishment of green bond certification schemes that meet international standards by local entities.

Ongoing Initiatives

International Financial Centre

(a) *Developing Hong Kong into a broader platform for fund raising in the new economy*

14. The Hong Kong Exchanges and Clearing Limited ("HKEX") has earlier conducted market consultation on the concept of introducing a new board, with the aim to widening capital markets access by opening up to a more diverse range of issuers and enhancing the competitiveness of the listing platform in Hong Kong. The HKEX is now considering the views collected with a view to drawing up a more detailed proposal for consultation with the market.

(b) *Offshore RMB business*

15. 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 July this year, RMB deposits and outstanding RMB

certificates of deposit amounted to around RMB600 billion. According to a report by Society for Worldwide Interbank Financial Telecommunication ("SWIFT"), around 70% of the world's RMB payment transactions were processed via Hong Kong in the first half of this year. In July this year, the investment quota of the RMB Qualified Foreign Institutional Investors ("RQFII") for Hong Kong increased from RMB270 billion to RMB500 billion. Hong Kong remains to be the region with the largest RQFII quota in the world.

16. Over the past few years, a number of mutual market access arrangements between the two places have been launched, e.g. Bond Connect, Shenzhen-Hong Kong Stock Connect and the mutual recognition of funds between the Mainland and Hong Kong. All these initiatives strengthen Hong Kong's status as the prime gateway for overseas investors to enter the Mainland financial markets. We will continue to closely engage the industry and relevant Mainland authorities to explore expansion of the channels for two-way flow of cross-border RMB funds to reinforce and enhance the status of Hong Kong as a global hub for offshore RMB business. In deepening mutual financial market access between Hong Kong and the Mainland, we will explore the possibility of including in the two-way mutual access mechanism a wider range of investment products, such as exchange-traded funds, and extending the Mainland-Hong Kong Bond Connect to cover Southbound Trading. Further, regulatory authorities of the two sides are discussing how to establish an investor

identification system for Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect.

(c) *Development of Guangdong-Hong Kong-Macau Bay Area ("Bay Area") and Belt and Road Initiative*

17. To capitalise on the opportunities arising from the Bay Area and Belt and Road Initiative, we will leverage on Hong Kong's strengths as a global hub for offshore RMB business and international asset management centre and offer a wide range of financial services, including offshore RMB settlement, project financing, risk management, asset management, and capital management, for enterprises in the Bay Area and along the Belt and Road regions. It is expected that the planning of the Bay Area would help strengthen the connectivity of financial services, develop additional cross-border financing services to tie in with the growth of enterprises, and lower the thresholds of Hong Kong financial institutions entering other cities in the Bay Area.

(d) *Asian Infrastructure Investment Bank ("AIIB")*

18. Hong Kong became a member of the AIIB in June this year. We will actively encourage AIIB to leverage our status as an international financial centre and our capital markets to support the AIIB's operation.

(e) *Consolidate Hong Kong's position as a major asset management centre in the Asia-Pacific region*

19. With the sustained, rapid economic growth in the Asia-Pacific region, we must further enhance the competitiveness of the fund industry so as to tap into new markets. The Government will, through an array of measures, continue to strive to attract more funds of various types to develop their businesses in Hong Kong, thereby turning Hong Kong into a more full-fledged fund service centre and strengthening our position as a major international asset management centre. These measures include removing existing limitation in the legal structure, broadening the distribution network for our fund industry, and providing a more favourable tax environment.

20. The Amendment Bill to introduce a legal framework for the open-ended fund company ("OFC") as a fund vehicle structure in Hong Kong was passed by LegCo in June 2016. Subsequently, the SFC completed in August this year a public consultation on the subsidiary legislation and code setting out the operational and procedural details. The SFC is revising their proposals based on the comments received, aiming to table the subsidiary legislation before LegCo in the coming year. At the same time, we propose to extend profits tax exemption to onshore privately-offered OFCs, so that all types of OFCs may enjoy profits

tax exemption. This will enhance Hong Kong's competitiveness as a fund domiciliation platform. We introduced the relevant Amendment Bill into LegCo in June this year and will work with LegCo on its scrutiny of the Amendment Bill.

21. Meanwhile, we will continue to take forward our work on mutual recognition of funds ("MRF") arrangements. Such arrangements can expand the distribution network for Hong Kong's fund industry and provide more product choices to local investors. Following the Mainland-Hong Kong MRF arrangement implemented in July 2015, the SFC reached an agreement with the relevant regulatory authorities in Switzerland and France respectively in December last year and July this year, allowing eligible public funds to be distributed in each other's market through a streamlined vetting process. The SFC will continue its negotiations with other jurisdictions on MRF arrangements.

Financial Safety

(a) Anti-money laundering and counter-terrorist financing

22. Amidst global efforts to combat money laundering and terrorism, it is incumbent upon Hong Kong, as a member of the Financial Action Task Force, to implement the relevant international regulatory standards on anti-money

laundering and counter-terrorist financing. To this end, the Financial Services and the Treasury Bureau introduced into LegCo in June this year the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017, which prescribed statutory customer due diligence and record-keeping requirements for designated non-financial businesses and professions when they engaged in specified transactions, and the Companies (Amendment) Bill 2017, which required companies incorporated in Hong Kong to maintain beneficial ownership information. We hope LegCo will pass the two Bills as soon as possible, so that the amended Ordinances can come into operation on 1 March in the coming year to reinforce Hong Kong's credibility as a transparent, trusted and competitive international financial centre.

(b) *Statutory Corporate Rescue Procedure*

23. The Government is preparing a bill to introduce a statutory corporate rescue procedure and insolvent trading provisions to provide an option for companies in short-term financial difficulties to initiate the procedure, with a view to reviving their business, instead of pursuing immediate liquidation to wind up the company.

Enhancing the Mandatory Provident Fund ("MPF") System

24. 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 measures taken by MPFA to enhance market transparency and scheme administration efficiency, as well as to promote market competition in the past years, the average fund expense ratio ("FER") of MPF funds has dropped from 2.06% in 2007 to 1.56% in August this year, representing a reduction of about 24%. Also, from the launch of the Employee Choice Arrangement up to August this year, 229 MPF funds have reduced fees, representing about 49% 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 227 "low-fee funds" under 32 MPF schemes up to August this year, representing about 48% of the total number of MPF funds currently available for selection in the MPF market. The fee-controlled Default Investment Strategy ("DIS") (namely, a daily fee cap of 0.75 percent and an annual out-of-pocket expenses cap of 0.2 percent, both calculated as a percentage of the net asset value of the constituent funds under the DIS) was implemented on 1 April this year. It is envisaged that the fee-controlled DIS will promote competition among MPF service providers on fees and fund performance.

25. The Government and the MPFA have commenced work on the eMPF, a centralised electronic platform which will enhance the administrative

efficiency of the MPF schemes, thereby providing more room for fee reduction. A working group comprising all the 14 trustees who are operating MPF schemes was formed in June 2017 to steer the development of eMPF. Two task forces have been set up under the Working Group, to map out the technical requirements of the electronic platform as well as ways to promote digital take-up among users in handling their MPF matters.

THE TREASURY

New Fiscal Philosophy

26. We are committed to maintaining a business-friendly environment with a simple and low tax regime. Driven by economic restructuring and global competition, we will strategically deploy tax measures to foster the development of a diversified economy and enhance the competitiveness of Hong Kong.

27. The Government will implement two tax initiatives outlined in the Chief Executive’s Manifesto. First, this Bureau will implement the two-tiered profits tax rates regime, under which the profits tax rate for the first $2 million profits of corporations will be further reduced from 10% as proposed in the Chief Executive’s Manifesto to 8.25%, i.e. half of the profits tax rate. The profits thereafter will continue to be subject to tax assessment based on the standard rate

of 16.5%. For unincorporated businesses, mostly partnerships and sole proprietorships, the two-tiered tax rates will correspondingly be set at 7.5% (i.e. half of the current single rate) and 15%. The two-tiered regime seeks to reduce the tax burden of enterprises, especially SMEs, and to incentivize reinvestment. We will prepare legislation to effect the proposal in the coming year.

28. While the proposed two-tiered regime is designed to benefit all enterprises with assessable profits irrespective of size, we propose to limit its application to only one enterprise nominated from within the same group. This is to help focus the tax benefits to SMEs and prevent artificial splitting of enterprises for taking advantage of the proposed regime. On the assumption that 20% of the tax-paying enterprises are connected enterprises, the estimated tax revenue forgone arising from the implementation of the two-tiered profits tax rates regime will be about $5.8 billion per year.

29. Separately, we have completed examining the proposal to provide an enhanced tax deduction for research and development (“R&D”) expenditure. The Innovation and Technology Bureau (“ITB”) will consult stakeholders on the proposal and embark on follow up actions including legislative amendment.

30. We will maintain a close dialogue with stakeholders in order to formulate forward looking tax policies and measures that are conducive to Hong Kong’s development. In this connection, the Government will hold a “Summit

on New Directions for Taxation" on 23 October this year to solicit views from stakeholders on tax measures which will help boost the four pillar industries and foster the development of emerging industries. Speakers from the business community and the tax profession will share their insights on tax-related matters and exchange views with participants from different sectors.

International Tax Cooperation

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

32. In relation to automatic exchange of financial account information in tax matters ("AEOI"), we enacted the legislation to mandate financial institutions to collect clients' information for 75 jurisdictions in June this year. Up to end September this year, we have signed agreements with 14 jurisdictions for conducting AEOI on a bilateral basis.

33. As regards the measures to tackle base erosion and profit shifting ("BEPS") promulgated by the Organisation for Economic Co-operation and Development, we conducted a consultation exercise on the implementation of the BEPS package in late last year and issued a report in July this year on the

outcome of consultation as well as an implementation strategy. There is broad support for the proposed implementation strategy which focuses on the four minimum standards of the BEPS package and the codification of the transfer pricing principles into the Inland Revenue Ordinance (Cap. 112) whilst upholding Hong Kong's simple and low tax regime. We plan to introduce an amendment bill into the Legislative Council ("LegCo") by the end of this year.

34. The Government plans to extend the application of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ("Multilateral Convention") to Hong Kong, so that it can provide a platform for Hong Kong to exchange necessary information with other jurisdictions under AEOI and BEPS effectively. We will introduce an amendment bill into LegCo this month to empower the Chief Executive in Council to give effect to the Multilateral Convention and other agreements on international tax cooperation that apply to Hong Kong. Subject to the passage of the bill, we will recommend the Chief Executive in Council to make an order to declare that the Multilateral Convention shall have effect in Hong Kong.

35. Hong Kong has actively pursued a programme to sign Comprehensive Avoidance of Double Taxation Agreements ("CDTAs") with our trading partners worldwide to foster trade ties and avoid double taxation. We have signed CDTAs with 38 tax jurisdictions, of which 12 were among our top 20

trading partners and accounted for over 70% of the total trade value of Hong Kong in last year. This year, we have so far signed CDTAs with Belarus, Pakistan and Saudi Arabia. We will continue to expand Hong Kong's CDTA network, seeking in particular to commence negotiations with countries along the Belt and Road, in the hope that we can further expand our network and increase the total number of our CDTAs to 50 in the next few years.

Financial Services and the Treasury Bureau
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