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LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS
2018 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 is an important pillar of the Hong Kong economy, contributing to over one-sixth of our Gross Domestic Product and providing about 250 000 jobs which account for over 6% of the working population. Hong Kong's position as a leading international financial centre and its sound financial system are widely recognised. The Global Financial Centres Index published by the Z/Yen Group in September this year ranked Hong Kong the third global centre, only behind New York and London. The International Monetary Fund also commended that Hong Kong was well placed to navigate challenges given its ample fiscal reserves and robust financial regulatory and supervisory frameworks.

3. Nevertheless, the Government and regulators will stay vigilant and closely monitor the latest development of the global and local financial markets. Trade dispute between the US and Mainland China would weigh on global economic sentiment as well as trade and investment activities. The evolving Brexit development, the continuous normalisation of monetary policy by US and

European central banks, as well as the depreciation of emerging market currencies, might render the global financial and asset markets more volatile.

4. Financial stability and the integrity and robustness of our financial markets are of crucial importance. We will make every effort to ensure the proper and smooth functioning of our financial system, by strengthening the protection and resilience of our financial systems and enhancing our risk management and fund raising capacity. We will also enhance our regulatory framework to strengthen financial safety to reinforce investors' confidence. We will consolidate Hong Kong's status as an international financial centre and asset and wealth management centre in the Asia-Pacific region, develop Hong Kong into a broader and deeper platform for fund raising and promote diversified development of our financial markets. At the same time, we will capitalise on the opportunities presented by the Belt and Road Initiative and the Guangdong-Hong Kong-Macao Greater Bay Area ("Greater Bay Area") development, advance financial cooperation with the Mainland and further develop our offshore Reminbi ("RMB") business.

New Initiatives

(a) *Enhancing Hong Kong's status as a regional insurance hub*

5. The Belt and Road Initiative promotes the development of infrastructure and trade in countries along the routes. It generates demand for insurance and risk management services for large-scale infrastructure and investment projects, thereby bringing opportunities to the insurance industry of Hong Kong. To strengthen Hong Kong's status as a regional insurance hub, the Government will implement tax relief proposals to promote the development of marine insurance and the underwriting of specialty risks in Hong Kong (e.g.

political risks and war risks). The Government will also amend the relevant legislation to allow for the formation of special purpose vehicles specifically for issuing Insurance Linked Securities ("ILS") (e.g. catastrophe bond) in Hong Kong, so as to broaden the capacity of risk management tools in the Hong Kong market[1]. We will work out the implementation details and legislative proposals in consultation with the Insurance Authority ("IA") and relevant Government departments, and liaise closely with the stakeholders in the process. Our target is to introduce the relevant amendment bills into the Legislative Council ("LegCo") in the 2019/20 legislative session.

(b) *Provision of seed money to Financial Reporting Council for auditor regulatory reform)*

6. We have introduced the Financial Reporting Council (Amendment) Bill 2018 into LegCo to press ahead with the reform for regulatory regime on auditors of listed entities. Under the proposed new regulatory regime, the functions of the Financial Reporting Council will be expanded so that it will become the independent and full-fledged regulator for auditors of listed entities. We will provide a lump sum of not less than $300 million as seed money to the Financial Reporting Council after the enactment of the amendment bill, so as to facilitate a smooth transition of the Financial Reporting Council from the existing auditor regulatory regime to the new regime.

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1 In simple terms, ILS is a tool to securitise insurance risks, so as to transfer the risks underwritten to capital markets. On the other hand, institutional investors may invest in instruments uncorrelated with the economic cycle in order to diversify risks.

Ongoing Initiatives

International Financial Centre

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

7. The Hong Kong Exchanges and Clearing Limited ("HKEX") has implemented the new listing regime to facilitate the listings of companies from the emerging and innovative sectors in Hong Kong since end-April this year. Subject to suitable investor protection measures, the new listing regime allows the listing of companies with weighted voting rights structure from the emerging and innovative sectors, and pre-profit/pre-revenue biotech companies on the Main Board. The HKEX will continue to enhance the listing regime with a view to further strengthening Hong Kong's overall competitiveness vis-à-vis other major international listing venues and developing Hong Kong into a premier fund raising platform for companies.

(b) *Offshore Renminbi ("RMB") business*

8. We have been promoting the development of offshore RMB business in Hong Kong since 2004. With the support of the Central Government, Hong Kong continues to be the world's largest offshore RMB business hub having the largest RMB Qualified Foreign Institutional Investors ("RQFII") quota, with a leading position in RMB settlement, financing and asset management to provide a diversified range of RMB products and services. As of end-July this year, RMB deposits and outstanding RMB certificates of deposit amounted to over

RMB650 billion and over 70% of the world's RMB payment transactions were processed via Hong Kong[2].

9. This year, we have continued to enhance mutual market access schemes between the two places. With effect from 1 May 2018, the daily quota of each of the northbound trading links under Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect was quadrupled to RMB52 billion, while that of each of the southbound trading links was quadrupled to RMB42 billion. Hong Kong's capital markets can contribute further as the country continues to open up its financial services sector. We will continue to closely engage the industry and relevant Mainland authorities to explore expansion of the channels for two-way flow of cross-boundary RMB funds to reinforce and enhance the status of Hong Kong as a global hub for offshore RMB business.

(c) *Opportunities arising from development of the Guangdong-Hong Kong-Macau Greater Bay Area and Belt and Road Initiative*

10. To capitalise on the opportunities arising from the development of the Greater Bay Area and the Belt and Road Initiative, we will leverage on Hong Kong's strengths as a leading international financial centre, a global hub for offshore RMB business and an international asset and wealth management centre and offer a wide range of financial services, including offshore RMB business, project= financing, risk management, asset and capital management, for enterprises in the Greater Bay Area and along the Belt and Road regions. We expect to enhance and develop additional cross-boundary financial services to

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2 According to a report by Society for Worldwide Interbank Financial Telecommunication ("SWIFT").

promote the flows of factors of production (including capital) and facilitate the economic development therein.

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

11. To strengthen the FSDC’s role in the development of Hong Kong’s financial services industry, the Government will allocate resources to the FSDC through recurrent subvention. The FSDC has recently completed the incorporation procedures as a company limited by guarantee in September 2018, and has commenced the recruitment of its own executive team and the setting up of its own office. The FSDC will enhance its functions in conducting strategic research and formulating recommendations to the Government on the sustained development of Hong Kong's financial services industry, actively promoting Hong Kong's financial services industry through a wide range of marketing campaigns held locally and overseas, and assisting in nurturing human capital in the industry.

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

12. We will continue to develop our market through different measures, including improvement and expansion of our legal structure, so that Hong Kong’s position as a major international asset and wealth management centre can be consolidated. To increase Hong Kong’s attractiveness as a base for fund development, the open-ended fund company regime and the associated profits tax exemption arrangement have started to operate on 30 July 2018. We are also examining the suggestion of introducing a limited partnership regime for private equity funds in Hong Kong. This should allow more choices of fund structure for the industry. Furthermore, we are reviewing the tax arrangements applicable

to the fund industry. We plan to introduce a legislation by the end of the year so that different types of onshore funds, like offshore funds, can enjoy profits tax exemption. We will also continue with our work on the mutual recognition of funds ("MRF") arrangements with other jurisdictions to broaden the distribution network for our fund industry. In addition to the Mainland, Switzerland and France, we reached an agreement with the United Kingdom earlier this month (on 8 October 2018) on MRF.

(f) *Green finance*

13. We aim to develop and firmly establish Hong Kong as a leading hub for green finance in the region, with focus on Mainland China and economies along the Belt and Road. By leveraging our strengths and advantages as a leading international financial centre, we seek to create values through sophisticated professional services and our unparallelled expertise and reputation in the provision of financial services. The Government would facilitate and provide the necessary infrastructure and catalyst for jump-starting market developments. We will at the same time build up our international profile on green finance with increased international visibility and proactive promotion targeting audience overseas.

(g) *Financial technologies ("Fintech")*

14. The Government will continue to promote the development of Fintech through a five-pronged approach, namely promotion, facilitation, regulation, talent and funding. Some major Fintech initiatives have recently been, or will soon to be, launched. The "Faster Payment System ("FPS")" went live in September. It connects banks and stored-value facility ("SVF") operators on the same platform and enables the public to transfer funds anytime, anywhere,

across different banks and SVF operators instantly through mobile phone numbers or email addresses. The HKMA has also rolled out the “Common QR Code Standard for Retail Payments” to facilitate the acceptance of different payment schemes by using a single QR code amongst merchants.

15. Looking ahead, we expect the first batch of virtual bank licence(s) will be granted towards the end of 2018 or early 2019, providing the public with more choices in addressing their banking needs. The Open Application Programming Interface (“API”) framework for the Hong Kong banking sector will be also implemented, enabling collaboration between banks and third party service providers to offer innovative and integrated services that improve customer experience.

16. We envisage that these Fintech initiatives will upkeep the competitiveness of our financial services industry and provide greater convenience and new experience to the public. While we embrace the innovations brought about by Fintech, our financial regulators will continue to closely monitor market developments in order to protect the investing public.

(h) *Investor education and protection*

17. With the continuous innovations in the financial market and products, the Government will continue to support the investor education efforts of the financial regulators and the Investor Education Centre. Through promotion of financial management education through various channels and approaches, members of the public will be reminded of the features and risks of financial products. This helps enhance the financial literacy of the public so that their rights can be better protected.

Enhancing Regulatory System and Financial Safety

(a) *Anti-money laundering and counter-terrorist financing (“AML/CTF”)*

18. 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 AML/CTF. During the past year, Hong Kong has commenced the operation of a number of new legislations, including the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018, which prescribes statutory customer due diligence and record-keeping requirements for designated non-financial businesses and professions when they engage in specified transactions and introduces a licensing regime for trust or company service providers; the Companies (Amendment) Ordinance 2018, which requires companies incorporated in Hong Kong to maintain beneficial ownership information; the United Nations (Anti-Terrorism Measures) (Amendment) Ordinance 2018, which implements the relevant requirements of the United Nations Security Council (“UNSC”) Resolution 2178; the United Nations Sanctions (Amendment) Ordinance 2018, which enables regulations made under that Ordinance to impose sanctions directly against persons (including groups, undertakings and entities) designated by the UNSC; and the Cross-boundary Movement of Physical Currency and Bearer Negotiable Instruments Ordinance, which establishes a declaration and disclosure system to detect the physical cross-boundary transportation of large quantities of cash and bearer negotiable instruments. The above legislations will go a long way towards enhancing the robustness of Hong Kong’s AML/CTF regime. The Government will continue to monitor the latest security landscape and strengthen our AML/CTF regime as appropriate having regard to international standards, so as to reinforce Hong

Kong's credibility as a transparent, trusted and competitive international financial centre.

(b) *Strengthening the regulatory framework of the insurance industry*

19. Since the IA took over the regulatory functions of the then Office of the Commissioner of Insurance in June 2017, we and IA have actively pursued a number of measures to strengthen the regulatory framework for the insurance industry to enhance the protection of policy holders and promote the stable development of the insurance industry. The latest progress on the measures is set out below.

20. As for the statutory licensing regime for insurance intermediaries, the IA will take over the functions of the existing three Self-regulatory Organizations[3] ("SROs") to regulate insurance intermediaries. The IA is formulating the relevant rules, codes and guidelines. The new licensing regime for insurance intermediaries is expected to commence operation in mid-2019.

21. The Policy holders' Protection Scheme ("PPS") aims to provide affected policy holders with a safety net in the event of insurer insolvency. We are now working with the IA and relevant Government departments to prepare the enabling legislation for establishing the PPS. We will continue to liaise with the industry and relevant stakeholders in the process. Our target is to introduce the relevant bill into LegCo in the 2019/20 legislative session.

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3 The three SROs are the Insurance Agents Registration Board established under the Hong Kong Federation of Insurers, the Hong Kong Confederation of Insurance Brokers and the Professional Insurance Brokers Association.

22. To make capital requirements more sensitive to the level of risk borne by insurance companies, and align Hong Kong's regulatory regime with international standards, we are actively preparing for the implementation of a Risk-based Capital ("RBC") Regime[4] to replace the existing rule-based capital adequacy regime. The IA is conducting the second Quantitative Impact Study ("QIS") with the industry, and expects to complete data collection and start data analysis by the end of 2018. After the completion of an estimate of three rounds of QIS, we intend to consult the industry on the draft rules of the RBC Regime in 2020. Our target is to introduce the relevant amendment bills into LegCo in the 2020/21 legislative session.

(c) *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. We plan to introduce the bill into LegCo within 2018/19 legislative session.

(d) *Enhancing the Mandatory Provident Fund ("MPF") System*

24. The Government and the Mandatory Provident Fund Schemes Authority ("MPFA") have been striving to improve the MPF System and reduce the fees of MPF schemes. Since the launch of the fee-controlled Default Investment Strategy ("DIS") on 1 April 2017, more than $29 billion of assets was

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4 The proposed RBC regime comprises three pillars representing requirements for quantitative assessment aspects (Pillar 1), corporate governance and risk management aspects (Pillar 2) and disclosure (Pillar 3).

invested in the two Constituent Funds under the DIS. The Government will review the fee cap level for the two Constituent Funds by April 2020 with a view to adjusting it further downward.

25. The Government and the MPFA are collaborating to put in place a centralised electronic platform to enhance the administrative efficiency of the MPF schemes, thereby providing more room for fee reduction. We will brief the Panel on Financial Affairs of LegCo by the end of this year on the progress as well as the financial implications for building the platform as a public utility.

(e) *Tax deductions for deferred annuity premiums and Mandatory Provident Fund voluntary contributions*

26. The 2018-19 Budget Speech suggested the introduction of tax deductions to encourage the public to take out deferred annuity or make MPF voluntary contributions. In consultation with the IA and the MPFA, we have discussed the implementation details with the industry, and sought the Panel's comments on the proposed implementation details in May 2018. We are currently working on the relevant amendment bill. The IA is also formulating guidelines on the specific requirements for deferred annuity products to be eligible for tax deductions. Our target is to introduce the relevant amendment bill into LegCo in the 2018/19 legislative session. Subject to the passage of the bill, the proposed deductions will be effective from the year of assessment of 2019/20.

THE TREASURY

Tax Policies

27. The HKSAR Government promotes the flow of scientific research talents between Hong Kong and the Mainland so as to actively participate in the development of the Guangdong-Hong Kong-Macao Greater Bay Area and turn the latter into a global technology and innovation hub. To this end, we are working with the relevant Mainland authority to include an Article on Teachers and Researchers ("Teachers' Article") in the Comprehensive Avoidance of Double Taxation Arrangement with the Mainland so as to reduce the tax liability of teachers and researchers from Hong Kong who work in the Mainland. Since Hong Kong's taxation regime adopts the territorial source principle, the relief provided by the Teachers' Article may lead to double non-taxation of certain individuals. We will need to amend the Inland Revenue Ordinance ("IRO") to address the problem.

28. The two-tiered profits tax rates regime has taken effect from 1 April 2018. The profits tax rate for the first $2 million profits of corporations is reduced to 8.25%, thereby benefitting all eligible enterprises with assessable profits, irrespective of their size. To ensure that the tax benefits will target small and medium enterprises ("SMEs"), the lower rate is restricted to only one

enterprise nominated among connected entities. The IRO has prescribed a simple, clear and objective definition for connected entities.

29. On the international front, we continue to deliver our commitments to enhancing tax transparency and preventing cross-border tax evasion. In relation to automatic exchange of financial account information in tax matters (“AEOI”), the first exchanges with the relevant jurisdictions were smoothly conducted in September 2018. We will take forward the necessary legislative amendments to align our AEOI regime with the requirements of the Organisation for Economic Co-operation and Development (“OECD”). Apart from making the technical amendments as reported to this Panel in July 2018, we also plan to remove Mandatory Provident Fund Schemes, Occupational Retirement Schemes registered under the Occupational Retirement Schemes Ordinance (Cap. 426) and credit unions from the list of non-reporting financial institutions ("NRFIs") under Schedule 17C to the IRO because these entities do not meet the requirements of NRFIs as promulgated by the OECD. As a result, these entities will need to adopt the Common Reporting Standard for AEOI for reporting the relevant financial account information to the Inland Revenue Department (“IRD”). We have briefed relevant stakeholders on the above developments and they in general expressed understanding on the need for Hong Kong to comply with the OECD’s requirements.

30. To implement OECD's measures to tackle base erosion and profit shifting ("BEPS"), the Inland Revenue (Amendment) (No. 6) Ordinance 2018 was enacted in July 2018 to implement the minimum standards of the BEPS package and codify the transfer pricing principles. The IRD will promulgate the implementation arrangements via its Departmental Interpretation and Practice Notes.

31. Hong Kong has been actively expanding our network for Comprehensive Avoidance of Double Taxation Agreements ("CDTAs") with our trading and investment partners. We have signed CDTAs with 40 jurisdictions, of which 13 were among our top 20 trading partners and accounted for 73% of the total trade value of Hong Kong in 2017. Two of them, namely those with India and Finland, were signed in 2018. Our target is to increase the total number of our CDTAs to 50 in the next few years.

Pro-innovation government procurement

32. We will introduce a new pro-innovation government procurement policy to provide a more enabling environment that encourages bureau/departments to adopt innovative suggestions and facilitates the participation of start-ups and SMEs in government procurement.

33. We will amend the Stores and Procurement Regulations ("SPRs") to reflect the policy intention that government procurement promotes fair, competitive and open bidding receptive to innovation. To address the misconception that government procurement means the selection of the lowest priced bid with no regard to quality, we will also make clear in the SPRs that the guiding principle of "value for money" which underpins our procurement regime should be assessed in terms of economy, effectiveness and efficiency, taking into account the total costs involved (measured on a whole-life costing basis) and the quality of the goods/services procured. In other words, "value for money" means the optimal use of resources to achieve the best outcomes.

34. To encourage procuring departments to compare bids not just on price but also on quality, we will promote a wider use of marking schemes. We will also raise the allowed range of technical weighting (vis-à-vis price) from the current 30% - 40% to 50% - 70%. The procuring departments will be required to preserve a minimum percentage of technical marks for assessing innovative suggestions submitted by tenderers, so that innovative tenders will stand a better chance of success.

35. Since SMEs and start-ups may have limited experience and track record, especially in undertaking government contracts, to minimize the entry

barrier we will advise procuring departments that tenderers' experience should in general not be set as essential requirements[5] unless absolutely necessary and with the prior approval of the relevant tender boards. While tenderers' experience may continue to be assessed in the tender evaluation process, to avoid placing start-ups and SMEs in an unduly disadvantageous position, its weighting in the marking scheme should in general be capped at 15% of the total technical marks.

36. The new regime will preserve flexibility for procuring departments so that, where justified, they may seek the approval of the relevant tender boards to go beyond the allowed range of technical or price weighting in tender evaluation, or the percentage of technical marks for innovative suggestions or experience.

37. In addition, the relevant government departments will collaborate and introduce measures to facilitate the participation of SMEs and start-ups in government procurement. The Government Logistics Department ("GLD") will publish government procurement plans to facilitate planning by prospective tenderers, and join pre-tendering briefings to help SMEs and start-ups familiarise

[5] Essential requirements (such as specification of goods, holding of necessary licence, etc.) are the first threshold of a tender assessment exercise. Only tenders that meet such requirements (i.e. conforming bids) will be considered for technical assessment and price evaluation.

with government procurement procedures. The Innovation and Technology Bureau ("ITB") and Efficiency Office ("EffO") will line up with innovation and technology ("I&T") industry players to organise trade shows to showcase available innovative solutions and enhance the awareness and knowledge of procuring departments of the latest technology that can be sourced from the market. To support pro-innovation procurement, the Commerce and Economic Development Bureau ("CEDB") and EffO will also formulate guidelines to encourage procuring departments to adopt "design thinking", so that they will proactively seek a better understanding of the needs of users before they draw up tender briefs.

38. We are working on the implementation details so as to roll out the new policy and arrangements in April 2019.

Financial Services and the Treasury Bureau
October 2018