LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS
2019 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 nearly one-fifth of our Gross Domestic Product and providing over 260 000 jobs which account for nearly 7% 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 Hong Kong for maintaining robust financial regulation and supervision and its continued efforts to maintain competitiveness and expand its role as a leading financial centre through various initiatives.

3. Meanwhile, the US-Mainland trade conflicts weigh on the global economic sentiments, with repercussions on global trade and investment activities. Coupled with the economic slow-down in the Europe, monetary policies of the US Federal Reserve, geopolitical tensions, as well as other uncertainties in the global, regional and local environment, the global and Hong Kong's financial and asset markets have become more volatile.

4. Nevertheless, different facets of Hong Kong's financial system have been functioning smoothly and orderly so far. In the money market, the Hong Kong dollar exchange rate has been stable. The Linked Exchange Rate System has served as the cornerstone for Hong Kong's monetary and financial stability over the past 36 years, and continues to operate orderly. The liquidity of the banking system in Hong Kong remains ample, and the interbank market continues to operate orderly. There was no noticeable outflow of funds from the Hong Kong dollar or from the banking system based on the latest statistics on deposits and money supply. Article 112 of the Basic Law safeguards the free flow of capital within, into and out of Hong Kong.

5. Financial regulators have conducted stress tests, and the results indicate that even in extremely adverse situations, banks, intermediaries in the securities sector and insurers will still be able to meet the relevant regulatory requirements. The Government and financial regulators will continue to stay alert and gear up our monitoring, strengthening and preventive measures.

6. The core competitiveness of Hong Kong as an international financial centre remains well in place. Although some rating agencies have adjusted downward Hong Kong's credit rating, they affirmed that Hong Kong's strong fiscal capacity will help the city weather shocks, while other agency affirmed Hong Kong's credit rating recently.

7. Meanwhile, as an international financial centre and the pivotal gateway to the Mainland of China, the Government will continue to sharpen our competitive edge and develop Hong Kong into a broader and deeper fundraising platform. We will also capitalise on the opportunities presented by the Guangdong Hong Kong-Macao Greater Bay Area ("Greater Bay Area") and the Belt and Road Initiative, and further enhance Hong Kong's position as a centre for offshore Renminbi ("RMB") business, wealth management, risk management, and green finance, with a view to promoting diversified development of our financial markets.

New Initiatives

(a) Limited Partnership Regime for Private Equity Funds

8. In recent years, private equity ("PE") funds have become a key impetus to the growth of asset and wealth management business and start-ups. Hong Kong, as the second largest PE fund hub in Asia[1], is well placed to further expand business in the field. Providing a fit-for-purpose legal structure for PE funds to establish and operate in Hong Kong has become indispensable. Limited partnership is a legal form popular among PE funds. We propose to establish a new regime for registration of eligible funds to be set up in the form of limited partnership under the administration of the Companies Registry. The new regime would strive to meet the industry's operational needs. We consulted the industry on our proposals in the third quarter this year. We are reviewing the feedback and plan to consult this Panel shortly for formulating the legislative proposals. The new regime will be a key move in developing Hong Kong into a

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1 The total capital under management by the some 550 private equity funds in Hong Kong was over $1.18 trillion (about US$152 billion) as at end-June 2019 (Asian Venture Capital Journal data). This puts Hong Kong second in Asia, after the Mainland.

full-fledged fund service centre and bring more business and job opportunities to the whole value chain of fund administration services.

(b) Uncertificated Securities Market ("USM") Regime

9. We will foster the establishment of an USM regime with a view to enhancing and modernising our financial market infrastructure. The Securities and Futures Commission ("SFC"), the Hong Kong Exchanges and Clearing Limited ("HKEX") and the Federation of Share Registrars Limited have conducted a joint consultation on the latest proposal for implementing an USM regime in Hong Kong earlier this year. We also briefed this Panel on the proposal during the consultation period. We are working on the implementation details and preparing the necessary legislative amendments having regard to the feedback received from the consultation.

(c) Promoting mutual access of financial services in the Guangdong-Hong Kong-Macao Greater Bay Area

10. The Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area supports the consolidation and strengthening of Hong Kong's status as an international financial centre, leveraging our leading position in the financial services sector. To this end, together with the relevant regulators, we maintain close liaison with the Mainland authorities with a view to taking forward more concrete measures to foster financial cooperation in the Greater Bay Area, including expanding further the scale and scope of cross-boundary use of RMB, enhancing connectivity among the financial markets and promoting measures to facilitate cross-boundary wealth management.

(d) Strengthening Financial Technology ("Fintech") related training and set up an in-town Fintech centre

11. The application of Fintech will not only enhance the competitiveness of traditional financial institutions, but will also bring about paradigm shifts. We need to equip in-service financial practitioners to deepen their understanding of Fintech, so as to further drive the application of Fintech in these traditional financial institutions. In this connection, Cyberport will strengthen the provision of Fintech-related training for in-service financial practitioners, which will include seminars, workshops, and networking opportunities at different levels and under different themes. We expect to launch such Fintech-related training in early 2020.

12. In addition, we will establish an in-town event space for Fintech companies, start-ups, traditional financial institutions, innovative laboratories and

venture capital companies to connect and exchange ideas, explore new business collaborations and drive new demands for Fintech. We are planning to make use of Government office space in Wanchai for the purpose, which is tentatively named "Fintech @ Gloucester". We will entrust Cyberport to operate the event space in view of its rich experience in supporting the local Fintech scene.

Ongoing Initiatives

International Financial Centre

(a) Consolidating Hong Kong's position as a major asset and wealth management centre in the Asia-Pacific region

13. To entrench Hong Kong's position as a major asset and wealth management centre in the Asia-Pacific region, we will continue to take a multi-pronged approach, including diversifying our fund structures to attract more offshore funds coming onshore. Apart from the limited partnership regime mentioned above, we introduced the open-ended fund company regime in July 2018. This allows funds to be set up in the form of company apart from unit trust. The first local open-ended fund company has been incorporated under the regime. Moreover, providing a facilitating tax environment is also crucial. Different types of onshore and offshore privately offered funds can enjoy profits tax exemption under the Inland Revenue Ordinance with effect from 1 April 2019. On expanding our fund distribution network, we will continue with our work on the mutual recognition of funds ("MRF") arrangements with other jurisdictions. In addition to the Mainland, Switzerland, France and the United Kingdom, we reached an agreement with Luxembourg and the Netherlands on MRF this year.

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

14. The HKEX implemented a new listing regime in Hong Kong to facilitate the listings of companies from the emerging and innovative sectors in end-April last year. On 18 October this year, the Shanghai Stock Exchange and the Shenzhen Stock Exchange announced respectively that with effect from 28 October this year, companies with weighted voting rights structure as listed in Hong Kong under the new listing regime could be included as eligible securities under the Southbound Trading of Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect ("Stock Connect") upon fulfillment of certain criteria. 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.

(c) <u>Enhancing Hong Kong's status as an international insurance hub</u>

15. The Government will continue to enhance Hong Kong's status as an international insurance hub and assist the insurance industry to seize new business opportunities. Having consulted the industry and this Panel, we plan to reduce profits tax rate by 50% (i.e. 8.25%) for general reinsurance business of direct insurers, selected general insurance business of direct insurers and selected insurance brokerage business, in order to stay competitive in general insurance and reinsurance business. In addition, we plan to enable the issuance of insurance-linked securities (e.g. catastrophe bond) by special purpose vehicles, so as to broaden the range of risk management tools in Hong Kong. We also plan to expand the scope of insurable risks by captive insurers set up in Hong Kong to meet the risk management needs of multinationals. Currently, we are pressing ahead with the preparatory work with a view to introducing the relevant bills into LegCo in the 2019/20 legislative session.

(d) <u>Offshore RMB business</u>

16. With the support of the Central Government, Hong Kong continues to be the world's largest offshore RMB business hub, with a leading position in RMB settlement, financing and asset management[2].

17. Over the past few years, a number of mutual market access schemes were launched, including Bond Connect, Stock Connect and the MRF between the Mainland and Hong Kong. Following the annual RMB sovereign bond issuance by the Ministry of Finance in Hong Kong for 11 years consecutively since 2009, the People's Bank of China issued RMB bills for the first time in Hong Kong in November last year and has since established a regular mechanism of central bank bill issuance in Hong Kong to enrich the spectrum of RMB financial products, thereby promoting RMB internationalisation further. We will continue to explore with the industry and relevant Mainland authorities on the expansion of channels for two-way flow of cross-boundary RMB funds to reinforce Hong Kong's position as a global hub for offshore RMB business.

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2 As at the end of August this year, RMB deposits and outstanding RMB certificates of deposit exceeded RMB660 billion; according to the Society for Worldwide Interbank Financial Telecommunication ("SWIFT"), more than 75% of global offshore RMB payments were processed via Hong Kong.

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

18. With a view to capitalising on the opportunities arising from the development of the Greater Bay Area and the Belt and Road Initiative, we will continue to leverage on Hong Kong's strengths as a leading international financial centre, a global hub for offshore RMB business and an international asset and risk management centre, by offering a wider range of financial services, including offshore RMB business, project financing, risk management and asset and capital management, etc. for enterprises in the region. We have been making progress in promoting facilitation measures relating to the daily lives of people in the Greater Bay Area, including cross-boundary payment services by individual e-wallet operators and the pilot service of opening bank accounts remotely by Hong Kong residents. We will continue our efforts in this regard.

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

19. To enable the FSDC to better discharge its functions with more flexibility, the FSDC has been incorporated as a company limited by guarantee with effect from September 2018. The Government provides funding to the FSDC in the form of annual subvention. With funding and a formal organisational set-up, the FSDC has recruited its own team to step up its efforts across the three core functions of its work, namely policy research, market promotion and talent development.

Financial Innovation

(a) *Green finance*

20. We will continue to develop and consolidate Hong Kong's position as a leading hub for green finance in the region. Following our successful inaugural green bond issuance under the Government Green Bond Programme in May this year, we will continue our role as a "facilitator" and provide the necessary infrastructure and catalyst for jump-starting market developments, so as to encourage more entities to arrange financing for their green projects through our capital markets and expand the local green investor base.

21. We will step up our promotion and publicity efforts to enhance our international profile in green finance including the co-organisation of the Sixth Climate Business Forum in early 2020 by the Hong Kong Monetary Authority with the International Finance Corporation, a member of the World Bank Group.

(b) Financial Technologies

22. The Government will continue to foster the development of Fintech through promotion, facilitation, regulation, talent and funding. A number of major Fintech initiatives were implemented in the past year. For instance, the Faster Payment System ("FPS") was launched in September 2018. Up to August 2019, it has recorded 3.4 million registrations. In August 2019 alone, it processed 3.5 million transactions, involving HKD58 billion and RMB1 billion. Riding on the successful roll-out of the FPS, taxes, rates and water charges bills issued from November 2019 onwards will be printed with FPS QR codes. Members of the public can settle these bills through the FPS. The Government is also exploring the acceptance of payments through the FPS at the counters of five Government departments[3] on a pilot basis.

23. Fintech is also being embraced across different financial services sectors. In the first half of this year, the Hong Kong Monetary Authority has granted eight virtual bank licences. These virtual banks will launch their services in the near term, offering more choices to consumers and facilitating financial inclusion. The Open Application Programming Interface ("API") framework for the banking sector is being implemented in phases[4], enabling collaboration between banks and third party service providers to offer innovative and integrated services that improve customer experience. The Insurance Authority ("IA") approved the first life virtual insurer in December 2018, offering products with simple structure, high protection element and low premium through digital distribution channels without the involvement of intermediaries. A non-life virtual insurer was subsequently authorised in October 2019 as well. As for the securities sector, the SFC issued the Guidelines on Online Distribution and Advisory Platforms, which became effective in July this year. The Guidelines provide tailored guidance on the design and operation of online platforms, including specific guidance on the provision of automated or robo-advice.

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3 Companies Registry, Immigration Department, Leisure and Cultural Services Department, Official Receiver's Office and Transport Department.

4 The banking industry is implementing the Open API framework in four phases. As of July this year, over 500 registrations from third-party service providers to access banks' Phase I (product information) Open APIs had been recorded. Banks would launch Phase II (customer acquisition) Open APIs in October 2019. The HKMA has also announced that it will work closely with the industry on defining a detailed set of technical standards for Phase III (account information) and IV (transactions) Open APIs. The set of standards is targeted to be published in 2020, followed by an implementation timetable.

24. Looking ahead, the application of Fintech will further enhance the competitiveness of our financial services industry and provide greater convenience and new experience to the public. As we embrace the innovations brought about by Fintech, our financial regulators will continue to be vigilant in monitoring market developments in order to protect the public.

Enhancing Regulatory System and Financial Safety

(a) Implementing the latest international standards on banking regulation

25. 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 stable development of the financial system. The Banking (Liquidity) (Amendment) Rules 2019 have just been tabled before the Legislative Council for negative vetting. The amendment rules seek to refine the computation rules for liquid assets of banks having regard to the latest Basel III standards, in a bid to enhance the resilience of banks.

(b) Anti-money laundering and counter-terrorist financing ("AML/CTF")

26. The Financial Action Task Force concluded a mutual evaluation on the AML/CTF regime of Hong Kong in mid-2019 and published the Mutual Evaluation Report of Hong Kong ("the ME Report") in September. Hong Kong has achieved satisfactory results in the mutual evaluation, with the Government's efforts in building a robust AML/CTF regime duly recognised by the international community. The ME Report commends Hong Kong for having a strong legal foundation and effective system for combatting money laundering and terrorist financing. Underpinned by a high-level commitment from the Government, the system is particularly effective in the areas of risk identification, law enforcement, asset recovery, counter-terrorist financing and international co-operation. The ME Report also sets out a number of recommendations on areas where Hong Kong should work on to further enhance the AML/CTF regime. The Government will carefully consider all recommendations, and consult Members on specific proposals to implement the relevant recommendations as appropriate.

(c) Strengthening the regulatory framework of the insurance industry

27. With the commencement of the new statutory regulatory regime for insurance intermediaries on 23 September 2019, the IA has assumed the responsibility for direct regulation of some 110 000 insurance intermediaries in

Hong Kong. Under the new regulatory regime, the IA has introduced changes in such areas as basic academic qualifications, annual Continuing Professional Development training, codes of conduct, and minimum capital and net asset requirements for broker companies, to cater for present day circumstances.

28. Going forward, we will continue to work with the IA to pursue a number of measures for the protection of policy holders and healthy development of the insurance industry. Having consulted the industry and this Panel, we are pressing ahead with the legislative exercise to improve the regulatory framework for the supervision of insurance groups where the holding company of an insurance group is incorporated in Hong Kong. Our target is to introduce the relevant bill into LegCo in the 2019/20 legislative session.

29. Moreover, we are preparing the enabling legislation for establishing the Policy Holders' Protection Scheme ("PPS") so as to provide affected policy holders with a safety net in the event of insurer insolvency. We are also preparing for the implementation of a Risk-based Capital ("RBC") Regime to replace the existing rule-based capital adequacy regime. Our target is to introduce into LegCo the bills on PPS and RBC in the 2020/21 legislative session and the 2021/22 legislative session respectively.

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

30. 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 $35 billion of assets was invested in the two Constituent Funds under the DIS. The Government will start reviewing the fee cap level for the two Constituent Funds by April 2020 with a view to adjusting it further downward.

31. Separately, the Government and the MPFA are collaborating to put in place an eMPF Platform to enhance the administrative efficiency of the MPF schemes, thereby providing more room for fee reduction. Our target is to issue the tender by the end of this year, with a view to completing the development of the Platform in 2022 and implementing the Platform by phases thereafter.

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

32. The Inland Revenue and MPF Schemes Legislation (Tax Deductions for Annuity Premiums and MPF Voluntary Contributions) (Amendment) Bill 2018 was passed in March 2019 and came into operation on 1 April 2019. It has

given effect to the relevant tax deductions announced in the 2018/19 Budget Speech to encourage the working population to take out deferred annuity or make MPF voluntary contributions. From the year of assessment 2019/20 onwards, taxpayers are entitled to tax deductions under salaries tax and personal assessment for their premiums paid to qualifying deferred annuities and contributions made to tax deductible MPF voluntary contribution accounts, subject to a maximum tax deductible limit of $60,000 each year per taxpayer. The public and the industry welcome the above arrangements and market response has been positive, with some 70 000 deferred annuity policies sold and 17 000 new tax deductible accounts opened so far.

(f) Implementation of the new regulatory regime for auditors

33. The Financial Reporting Council (Amendment) Ordinance 2019 was enacted by LegCo on 30 January 2019 and came into operation on 1 October 2019. Under the new auditor regulatory regime, the Financial Reporting Council ("FRC") is a full-fledged and independent oversight body for the regulation of Public Interest Entities auditors, and is responsible for the inspection, investigation and disciplinary functions with regard to these auditors. The Government has provided seed capital of $400 million to the FRC to facilitate its migration to the new regime and exemption of levy under the new regime for the first two years.

(g) Corporate Rescue Procedure

34. 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. In view of the complexity of the bill and the technical complexities therein, we will be having in-depth exchanges and discussions with stakeholders on specific areas. We plan to introduce the bill into LegCo in the second half of 2020.

THE TREASURY

Teachers and Researchers Article

35. To promote training, exchanges of talents and co-operation between the two places, and further drive the development of the Guangdong-Hong Kong-Macao Greater Bay Area, Hong Kong and the Mainland signed on 19 July 2019 the Fifth Protocol to the Arrangement between the Mainland of China and the

Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income. The Fifth Protocol adds a new teachers and researchers article to the Arrangement. With this new article, a qualified teacher or researcher, who is employed in Hong Kong or the Mainland and engages in teaching and research activities on the other side, shall be exempt from taxation on that other side for a period of three years, provided that the relevant income has been subject to tax on the side where the person concerned is employed. The Article will reduce the tax burden of eligible teachers and researchers who work across the boundary and, facilitate research and development co-operation in the Greater Bay Area. Both sides are working on the ratification procedures with a view to having the article applicable in the Mainland in any taxable year commencing on or after 1 January 2020 and in Hong Kong in any year of assessment commencing on or after 1 April 2020.

Comprehensive Avoidance of Double Taxation Agreements / Arrangements

36. We are committed to expanding Hong Kong's network of Comprehensive Avoidance of Double Taxation Agreements/Arrangements ("CDTAs") in order to further strengthen Hong Kong's position as an international trade, commercial and financial centre. With the signing of the two CDTAs with Cambodia and Estonia in 2019, we have already signed CDTAs with 42 jurisdictions, of which 13 were among Hong Kong's top 20 trading partners and accounted for 73% of our total trade value in 2018. Our target is to increase the total number of our CDTAs to 50 by end 2022.

Financial Services and the Treasury Bureau
October 2019