LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS
2020 Policy Address
Policy Initiatives of the Financial Services and the Treasury Bureau

INTRODUCTION

The 2020 Policy Address and Supplement set out the government initiatives in the coming year. This paper outlines various key policy initiatives relating to the Financial Services and the Treasury Bureau.

2. We will focus on three major policy initiatives in the coming year, including financial stability, striving for market development and alleviating economic shock.

FINANCIAL STABILITY

3. The financial services industry is an important pillar of the Hong Kong economy, contributing to about one-fifth of our Gross Domestic Product and providing more than 270 000 jobs which account for over 7% of the working population. Hong Kong's position as a leading international financial centre and its sophisticated financial system are widely recognised. The International Monetary Fund also commended the resilience of Hong Kong's financial system and the Linked Exchange Rate System ("LERS"), noting that a history of prudent macroeconomic policies has left Hong Kong with significant buffers to navigate through cyclical and structural challenges[1].

4. With the evolving situation of the Coronavirus Disease 2019 ("COVID-19"), and hence weakened economy in various regions, coupled with other uncertainties such as the Mainland-US conflicts, the global financial markets have become more volatile. Nevertheless, the financial system of Hong Kong is resilient with robust risk management. The LERS and different facets of the financial services sector have been operating smoothly. The Hong Kong dollar to US dollar exchange rate has stayed on the strong side this year and net inflow of nearly US$50 billion has been registered since April, reflecting investors' continuous confidence in Hong Kong's financial markets. Major banks' average liquidity coverage ratio exceeded 156%, and the average capital adequacy ratio

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1 International Monetary Fund (2019), People's Republic of China—Hong Kong Special Administrative Region: Staff Concluding Statement of the 2019 Article IV Consultation Discussions, p. 2 and 6. Available at: https://gia.info.gov.hk/general/201912/04/P2019120400324_331779_1_1575437235431.pdf.

exceeded 20%, both well above the international regulatory standards.[2] In the first ten months of 2020, the average daily turnover of the Hong Kong stock market reached $125 billion, an increase of 40% over the same period last year. The Government and the financial regulators will continue to closely monitor the market situation, with a view to ensuring financial stability.

STRIVING FOR MARKET DEVELOPMENT

5. Financial stability provided a sound foundation for our market development. Hong Kong possesses the institutional strengths of an international financial centre and is highly competitive. Under the "one country, two systems" principle, Hong Kong is well positioned to benefit from the opportunities arising from the vast Mainland markets while contributing to the reform and opening up of the financial market of the country at the same time. We will continue to enhance Hong Kong's position as an international financial centre, make good use of Hong Kong's connectivity with the Mainland and international markets, strengthen mutual market access and capitalise on the opportunities presented by the Guangdong-Hong Kong-Macao Greater Bay Area ("Greater Bay Area") development and the Belt and Road Initiative. We will also continue to develop the city into a broader and deeper fundraising platform and further enhance Hong Kong's position as a centre for asset and wealth management, offshore Renminbi ("RMB") business, international risk management as well as green and sustainable finance, and support the development of financial technology ("Fintech"), for developing Hong Kong into a comprehensive international financial centre with a wide range of services. The ensuing paragraphs elaborate on the various new initiatives and ongoing initiatives.

New Initiatives

(a) Promoting mutual capital market access

6. The mutual capital market access programmes including Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect ("Stock Connect") and Bond Connect launched in the past few years have been operating smoothly. These schemes do not only facilitate the two-way opening-up of the Mainland financial market, but also strengthen Hong Kong's role as an international financial centre.

2 Figures as at second quarter 2020 and end-June 2020 respectively.

7. With the support from the Central People's Government, we have accelerated the pace of the work in relation to the inclusion of pre-profit biotechnology companies listed in Hong Kong meeting certain prescribed criteria in the scope of eligible securities under Stock Connect. The stock exchanges in Hong Kong, Shanghai and Shenzhen published a joint announcement on 27 November 2020 regarding the details of the inclusion which would take effect in end-December 2020.

8. The above measures will further deepen the collaboration and interaction between the capital markets of Hong Kong and the Mainland. Currently, Hong Kong is the second largest listing venue for biotechnology companies. The inclusion of eligible pre-profit biotechnology companies under the scope of eligible securities of Stock Connect can deepen the liquidity of the biotechnology companies listed in Hong Kong and further enhance Hong Kong's competitiveness as a premier listing platform.

(b) *Promoting mutual access of financial services in the Greater Bay Area*

9. In May this year, the Central Government promulgated the "Opinion on Providing Financial Support for the Development of the Greater Bay Area" which supports promoting further financial liberalisation and innovation, deepening financial cooperation between the Mainland, Hong Kong and Macao, and elevating the role of the Greater Bay Area in supporting and leading the country's development and opening up. We will maintain close communication with the Mainland authorities to implement more concrete measures for opening up a broader market for the financial sector.

10. Among others, the People's Bank of China ("PBoC"), the Hong Kong Monetary Authority ("HKMA") and the Monetary Authority of Macao jointly announced in June the decision to implement the two-way cross-boundary wealth management connect pilot scheme ("Wealth Management Connect") to allow residents in Hong Kong, Macao and nine cities in Guangdong Province to carry out cross-boundary investment in wealth management products distributed by banks in the area. Not only will Wealth Management Connect address the wealth management needs of the residents, it will also promote the cross-boundary flow and use of RMB, reinforcing further Hong Kong's position as the global offshore RMB business hub and the international asset management centre. It is planned that for northbound and southbound, there will be an aggregate quota of RMB 150 billion in each direction and an individual investor quota of RMB 1 million. The HKMA is formulating the implementation details with relevant authorities with a view to expediting the implementation of the scheme.

11. For the insurance sector, we are actively discussing the implementation details with the relevant regulatory authorities and will strive for early establishment of after-sales service centres by Hong Kong insurance industry in the Mainland cities of the Greater Bay Area under the Mainland and Hong Kong Closer Economic Partnership Arrangement ("CEPA"), with a view to providing Hong Kong, Macao and Mainland residents who are holders of Hong Kong policies with comprehensive support in different areas including enquiries, claims and renewal of policies. Moreover, we will strive for early implementation of the "unilateral recognition" policy for motor insurance policies of Hong Kong vehicles entering Guangdong through the Hong Kong-Zhuhai-Macao Bridge. The policy extends the coverage of third-party insurance policies issued by Hong Kong insurers to cover third-party liability in the Mainland, thereby deeming such policies as equivalent to the mandatory traffic accident liability insurance in the Mainland.

(c) *Enhancing the position of Hong Kong as a major asset and wealth management centre in Asia*

12. In order to enhance the position of Hong Kong as a major asset and wealth management centre in Asia, we are working on three fronts, namely to promote real estate investment trusts, to promote the development of private equity funds and family office business.

(i) *Promoting real estate investment trusts in Hong Kong*

13. We also strive to promote real estate investment trusts ("REIT") in Hong Kong to develop Hong Kong into a vibrant REIT market in Asia. This will strengthen the capital raising function of Hong Kong as a premier asset and wealth management centre, and broaden the investment options with a relatively stable return for local investors. To this end, we are considering various measures through a multi-pronged approach, including relaxing the investment restrictions of REIT as appropriate, broadening the investor base, facilitating market operation through legislative and regulatory enhancements, and stepping up market promotion and investor education.

(ii) *Further promoting the development of private equity funds*

14. We have been striving to consolidate Hong Kong's position as an Asia's premier fund hub for private equity. We have three steps: the first step is to introduce new fund structures. We introduced the open-ended fund company and limited partnership fund regimes in July 2018 and August 2020 respectively. This gives investment funds options to set up in Hong Kong in the company or limited partnership forms, alongside the unit trust form, with a view to attracting

different types of funds (including private equity funds) to set up and operate in Hong Kong. 50 limited partnership funds have been set up in the past three months. On expanding our fund distribution network, we will continue with our work on the mutual recognition of funds ("MRF") arrangements with other jurisdictions. The Securities and Futures Commission has reached MRF arrangements with the Mainland, Switzerland, France, the United Kingdom, Luxembourg and the Netherlands.

15. The second step, as announced in the Policy Address, we will provide tax concession for carried interest issued by private equity funds operating in Hong Kong subject to the fulfilment of certain conditions. We have consulted the industry and are formulating the legislative proposal. Our target is to introduce an amendment Bill into the Legislative Council ("LegCo") shortly. The third step is to consider introducing measures to attract more funds which were set up overseas to domicile in Hong Kong. After completing these three steps, we are very confident that Hong Kong's attractiveness as a base for private equity fund operation will be substantially enhanced, which would facilitate the financial market development as well as providing wider source of funds for the innovation industry in Hong Kong.

(iii) *Promoting family office business in Hong Kong*

16. Furthermore, family office business has flourished in recent years, becoming an important growth segment in the asset and wealth management industry. To further develop the family office business in Hong Kong, Invest Hong Kong will set up a dedicated team to step up promotion of our advantages in local and other major markets, and offer one-stop support services to family offices which are interested in establishing a presence here.

(d) *Fintech*

17. The fourth major work on promoting market development is Fintech. Earlier, we announced two new policy initiatives during the Hong Kong Fintech Week, the Fintech Proof-of-Concept Subsidy Scheme and the public consultation on the regulatory framework for virtual asset service providers ("VASPs"). On the aforementioned subsidy scheme, we expect that through the provision of financial incentives, traditional financial institutions would be encouraged to partner with start-ups to conduct Proof-of-Concept projects, and to promote those projects which are successful, for wider application among financial institutions. We have met with the Fintech industry in Hong Kong on this, including virtual banks, virtual insurers, start-ups, technology providers and industry associations. We shall decide on the implementation details based on the views obtained.

18. As regards virtual assets, trading activities relating to these have developed rapidly in the recent years, posing fraud, money laundering, market manipulation and other risks to the financial system. To harness opportunities presented by financial innovation and promote orderly development of the market, the Government will establish a robust regulatory framework to supervise virtual asset trading platforms through a licensing system and attract high-quality VASPs to domicile in Hong Kong. The Government launched a public consultation on the proposed licensing regime for VASPs on 3 November 2020. The public consultation will last for three months until 31 January 2021.

Ongoing Initiatives

International Financial Centre

(a) Developing Hong Kong into a broader and deeper fundraising platform

19. To meet the fundraising needs of companies from the emerging and innovative sectors and to keep abreast with latest market development in order to stay competitive, the Hong Kong Exchanges and Clearing Limited ("HKEX") has implemented a new listing regime since end-April 2018 to allow the listing of companies with weighted voting rights ("WVR") structure and pre-profit biotechnology companies in Hong Kong. Since the implementation of the new listing regime, 36 companies have been listed under the new regime, and the total fund raised accounted for around 40% of the fund raised through initial public offerings during the same period (up to mid-November 2020). The figures show that the new listing regime has been successful in enhancing the attractiveness of Hong Kong's listing platform to companies from the new economy sector and strengthening Hong Kong's overall competitiveness vis-à-vis other major international listing venues.

20. HKEX also announced in end-October 2020 further grandfathering arrangements in respect of companies seeking secondary listing in Hong Kong. Under the further grandfathering arrangements, qualifying companies that have already listed on the specified overseas stock markets before end-October 2020 can apply for secondary listing in Hong Kong subject to the fulfilment of relevant investor protection safeguards notwithstanding they possess corporate WVR structures. The actual effect of the grandfathering arrangements is to allow more companies of different forms to secondary-list in Hong Kong, thereby further enhancing our competitiveness as an international premier fundraising platform.

21. Furthermore, we will foster the establishment of an Uncertificated Securities Market regime in Hong Kong in order to make good use of technology to modernise our financial market infrastructure and enhance the overall competitiveness of Hong Kong as the listing platform of choice. We are working on the implementation details and the drafting of the relevant legislative amendments. We plan to introduce the Bill into LegCo in the 2020/21 legislative session.

(b) *Enhancing Hong Kong's status as an international risk management centre*

22. The Government strives to enhance Hong Kong's status as an international risk management centre. To increase the competitiveness of the insurance industry and assist the industry to seize new business opportunities, we are actively taking forward various measures, which include reducing 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; facilitating the setting up of special purpose companies in Hong Kong for the issuance of insurance-linked securities; and expanding the scope of insurable risks by captive insurers set up in Hong Kong.

23. Two amendment Bills related to the above measures were passed by LegCo in July 2020. We are working with the Insurance Authority ("IA") on formulation of implementation details and drafting of related subsidiary legislation. The target is to implement the relevant measures in early 2021.

(c) *Offshore RMB business*

24. 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.

25. 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 12 years consecutively since 2009, the PBoC has also 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.

(d) *Opportunities arising from development of the Greater Bay Area and the Belt and Road Initiative*

26. 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 Hong Kong's strengths as a leading international financial centre, a global hub for offshore RMB business, an international asset and risk management centre as well as a green and sustainable finance hub, by offering diversified and one-stop financial services, including offshore RMB business, project financing, risk management and asset and capital management, etc. for enterprises in the region. In addition, we will continue to strengthen financial services supporting cross-boundary movement of individuals to facilitate residents' daily activities, open up new markets and business opportunities for the financial and professional services sectors and enhance measures on cross-boundary financial infrastructure.

Financial Innovation

(a) *Green and sustainable finance*

27. We will continue to elevate Hong Kong's position as a regional green and sustainable finance hub. Following the launch of the Green Bond Grant Scheme in 2018 and our successful inaugural Government green bond issuance last year, we plan to issue green bonds totalling $66 billion in the five years from 2020-21, having regard to the market situation, so as to continue to set an important benchmark for potential issuers in Hong Kong and in the region, and encourage more entities to make use of Hong Kong's capital markets as well as financial and professional services for green and sustainable investment, financing and certification.

28. Established in May this year, the Green and Sustainable Finance Cross-Agency Steering Group will provide strategic direction on regulatory policy and market development, with a view to elevating our on-going cross-agency efforts to the next higher level, enhancing Hong Kong's visibility and raising our international profile in green and sustainable finance.

(b) *Fintech*

29. The Government has been adopting a multi-pronged approach, i.e. promotion, facilitation, regulation, talent and funding, to support the development of Fintech. Notwithstanding the challenges brought to the economy by the COVID-19 pandemic, there are new growth opportunities for Fintech application and adoption at both the business and consumer levels. For instance, the delivery

of financial services through virtual banks and virtual insurers, payments and remittance through Fintech-enabled infrastructure (e.g. Faster Payment System), client acquisition through remote onboarding and robo-advisory service for wealth management are becoming mainstreamed. We shall continue work in this aspect.

30. On the promotion front, our annual flagship event, the Hong Kong Fintech Week, was held in November as a fully virtual experience. The event drew over 1.2 million viewers from over 130 economies through its online platform, satellite events and streaming partners in the Mainland. During the Fintech Week, other than the announcement of Fintech Proof-of-Concept Subsidy Scheme and public consultation on the licensing regime for VASPs as mentioned in paragraph 17 above, we have also announced a series of new initiatives, including a Commercial Data Interchange to facilitate lending to small and medium enterprises and a white paper on Regtech for the banking sector. Meanwhile, we are also following closely the development of Central Bank Digital Currency, including the Digital Currency/Electronic Payment being developed by the PBoC.

Enhancing Regulatory System and Financial Safety

(a) Implementing the latest international standards on banking regulation

31. Maintaining financial stability is vital to the development of Hong Kong as an international financial centre. The Banking (Capital) (Amendment) Rules 2020, passed by LegCo in May this year, will come into effect in June 2021, implementing two sets of capital standards promulgated by the Basel Committee on Banking Supervision ("the Basel Committee") for the treatment of banks' counterparty credit risk exposures to derivatives trades. We will also continue to implement other regulatory standards promulgated by international organisations including the Basel Committee and the Financial Stability Board, with a view to ensuring the robust development of the financial system.

(b) Strengthening the regulatory framework of the insurance industry

32. We will continue to work with the IA to pursue a number of measures for the healthy development of the insurance industry and protection of policy holders. Together with the IA, we have developed a group-wide supervision framework for the supervision of insurance groups where the holding company of the group is incorporated in Hong Kong, with a view to establishing Hong Kong as a preferred base for large insurance groups in Asia-Pacific. The relevant amendment Bill was passed by LegCo in July 2020. We are working with the IA on the drafting of related subsidiary legislation. The target is to implement the measure in early 2021.

33. Moreover, we are preparing for the implementation of a Risk-based Capital ("RBC") regime to replace the existing rule-based capital adequacy regime. We are also preparing the enabling legislation for establishing a Policy Holders' Protection Scheme ("PPS") so as to provide policy holders with a safety net in the event of insurer insolvency. Our target is to introduce into LegCo the bills on RBC and PPS in the 2021/22 and 2022/23 legislative session respectively.

(c) *Auditor regulatory regime*

34. The new auditor regulatory regime has been implemented since 1 October 2019. The Financial Reporting Council has smoothly transitioned to the new regime. As an independent auditor regulator, it is delivering its statutory functions on auditors of listed entities, including inspection, investigation and discipline, in accordance with the amended Financial Reporting Council Ordinance. We will continue to strengthen the auditor regulatory regime which underpins Hong Kong as an international financial centre.

(d) *Corporate rescue procedure*

35. 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 will introduce the Bill into LegCo in the first quarter of 2021.

(e) *Enhancing the Mandatory Provident Fund ("MPF") system*

36. 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 $61 billion of assets was invested in the two Constituent Funds under the DIS, accounting for nearly 6% of the total MPF net asset value. The Government and the MPFA are reviewing the fee cap level for the two Constituent Funds with a view to further lowering it.

37. Separately, the Government and the MPFA join hands on the development of the eMPF Platform, which will be a large-scale infrastructure of the financial industry that helps enhance the administrative efficiency of the overall MPF schemes and create more room for fee reduction. The first-stage legislative amendments for the establishment of the eMPF Platform were passed this July. Our target is to award the tender by the end of this year or early next year and strive to complete the second-stage legislative work within the 2021/22 legislative

session. We aim to put in place the Platform in 2022 at the earliest, so that MPF trustees can migrate to the Platform by phases in the transitional period of the following two to three years, thereby bringing benefits to scheme members in good time.

(f) *Tax deductions for deferred annuity premiums and MPF voluntary contributions*

38. Starting from 1 April 2019, the Government has provided taxpayers with tax deductions at a maximum limit of $60,000 each assessment year for their premiums paid to qualifying deferred annuities and contributions made to tax deductible MPF voluntary contributions accounts. From April 2019 to September 2020, members of the public bought around 152 000 deferred annuity policies (involving around $10.7 billion of annualised premium) and opened around 42 000 tax deductible accounts (accumulating around $3 billion contributions), reflecting that the tax deductions arrangements have been welcomed by the public and the industry. These arrangements also encourage members of the public to prepare for their retirement, as well as facilitate diversified development of the market.

ECONOMIC SHOCK ALLEVIATION

Abolishing Doubled Ad Valorem Stamp Duty ("DSD") on Non-residential Property Transactions

39. Besides market development, it is also important to alleviate the economic shock in Hong Kong. As a result of the economic downturn and uncertainties surrounding the COVID-19 pandemic, prices and transaction volumes for non-residential properties have been dropping over a period of time, signaling a slackening of market demand. Price indexes of office, retail and flatted factory premises dropped by 13%-19% from their peaks, while transaction volumes fell by over 80% when compared with the levels before the introduction of DSD. After a review, the Government considers it the right time to abolish DSD, in order to facilitate selling of non-residential properties by businesses to address their financial predicament or liquidity needs because of the economic downturn, and mitigate the impact of the pandemic on Hong Kong's economy and business activities. The Chief Executive in Council has therefore approved the introduction of the Stamp Duty (Amendment) Bill 2020 into the Legislative Council to abolish DSD and to revert the ad valorem stamp duty rates chargeable on non-residential property transactions to the Scale 2 rates with effect from 26 November. As an illustration, for a transaction involving a shop at a value of $8

million, a duty payer will save $300,000 in terms of ad valorem stamp duty as the ad valorem stamp duty rate will be reduced from 7.5% to 3.75%.

40. To allow the relevant property owners to benefit from the abolition of DSD as soon as possible, the Chief Executive has exercised her statutory powers and made the Public Revenue Protection (Stamp Duty) Order 2020 ("the Order") to give full force and effect of law to the Bill so long as the Order remains in force.

Job creation and talent development

41. We attach great importance to talents of the financial industry, especially the employment situation of graduates and young professionals amid the pandemic. We have launched the Fintech Anti-epidemic Scheme for Talent Development ("FAST") in July 2020 to help our Fintech community to tide over the near term challenge and grow the talent pool for the long term. Under the FAST scheme, eligible Fintech companies can receive 12-month salary subsidy for up to 1 000 full-time positions. By mid-November, some 650 applications have been received, of which more than 495 applications have been approved for recruitment.

42. Moreover, the Financial Services Development Council has received an allocation of $180 million from the Government to launch the Financial Industry Recruitment Scheme for Tomorrow ("FIRST"), expanding the coverage of subsidy to the banking, securities, insurance, MPF trustees and accounting industries. Under the FIRST scheme, a monthly government subsidy of $10,000 would be given to employers for each of the 1 500 job quotas. Nearly all the quotas have been successfully taken up by eligible financial services companies within three weeks upon the launch of the scheme.

Other ongoing initiatives of the Treasury Branch

Comprehensive Avoidance of Double Taxation Agreements

43. We are committed to expanding Hong Kong's network of Comprehensive Avoidance of Double Taxation Agreements ("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 Serbia and Georgia in 2020, we have already signed CDTAs with 45 jurisdictions. Most of them are Hong Kong's major trading partners, collectively accounting for 78% of our total trade value in 2019. We will continue our efforts in negotiating and concluding CDTAs with more trading partners, especially those who participate in the Belt

and Road Initiative, and strive to increase the total number of our CDTAs to 50 by end 2022.

Updating of procurement plans

44. The Government Logistics Department (GLD) regularly updates and publishes on its webpage the procurement plans of Government departments, so as to keep prospective bidders informed well in advance, thereby facilitating their early planning and preparation. Starting from October this year, GLD has increased the frequency of updating the procurement plans on its webpage for goods and general services, from once every half year to once every month, so as to keep enterprises (especially small and medium sized enterprises and start-ups) abreast of Government's latest procurement plans and encourage them to participate in tendering.

Financial Services and the Treasury Bureau
November 2020