

**Information Note for
LegCo Panel on Financial Affairs**

**Policy Initiatives of the
Financial Services and the Treasury Bureau**

Introduction

The 2004 Policy Agenda issued on 7 January sets out the Government's new and on-going initiatives over the next three and a half years. This note elaborates on those initiatives relating to the Financial Services and the Treasury Bureau in the 2004 Policy Agenda and informs Members of the progress regarding our initiatives in the 2003 Policy Agenda.

FINANCIAL SERVICES

2004 Policy Agenda

2. The financial services sector is a key pillar of our economy. We will continue to build on Hong Kong's strength as a major international financial centre (IFC) and the premier capital formation centre for China. We are mindful that there is no room for complacency and will spare no effort in further enhancing our competitiveness. Towards this end, we are committed to ensuring a fair, efficient and transparent regulatory regime, which is in line with international standards. Our specific initiatives are set out in the following paragraphs.

Quality of Market

3. To ensure the quality of our market, we together with the Securities and Futures Commission (SFC) and the Hong Kong Exchanges and Clearing Limited (HKEx) will continue to press ahead with the initiatives under the Corporate Governance Action Plan announced in January 2003, with a view to

upholding Hong Kong's well recognized reputation in this regard. For example, we will continue to proceed in phases the comprehensive Corporate Governance Review conducted by the Standing Committee on Company Law Reform (SCCLR). Another salient measure is to take forward the proposals to enhance the oversight of auditors and the quality of financial reporting, based on the outcome of the consultation conducted in late 2003. These proposals include the establishment of an Independent Investigation Board to enhance the oversight of the public interest activities of the auditing profession and a Financial Reporting Review Panel to oversee the application of accounting requirements and standards.

4. On listing, we recognise that the corresponding regulatory regime has to evolve with market developments and needs, in order to ensure that it continues to be user-friendly and effective in ensuring market quality in light of international development. For this purpose, the Government commenced in October 2003 a public consultation on proposals to enhance the regulation of listing. We will consider carefully the public views received and work closely with SFC and HKEx to draw up enhancement measures.

Market Development

5. On market development, we have been adopting a multi-pronged approach to facilitate the development of bond market. This includes stepping up engagement with the industry bodies and market players, encouraging public corporations to issue bonds, and exploring new channels for distribution of bonds. We will also ensure a conducive environment for bond market development by providing the necessary financial infrastructure, simplifying the issuance process, offering appropriate tax incentives and continuing related investor education.

6. To facilitate offers of investment and hence, consolidate Hong Kong's position as a premier capital formation and asset management centre, we will also revamp the existing regulatory regime to accommodate new offering structure and other market practices prevalent in developed markets

today. To take forward this enormous task, SFC will conduct a comprehensive review of all local legislation and procedures governing public offers as well as the regulatory reforms introduced in other jurisdictions, with a view to putting forward proposals for public consultation in September 2004. We shall proceed to amend the securities and companies legislation based on the outcome of this consultation exercise with a view to putting in place a modern regime governing offers of investment to the public.

7. On fund management, Hong Kong is well positioned to tap the world's savings and to be an international fund management centre. Our strengths lie in our highly efficient and well regulated financial industry, high concentration of fund management companies, efficient and well educated workforce, a stable currency, a low and simple tax regime and multiple distribution channels. We will continue to strive to provide a favourable environment for maintaining the presence of international fund management companies as well as attracting new players. We believe the fund management industry would benefit from our initiatives to enhance market quality and to promote market development mentioned in paragraphs 3 to 6 above. On the taxation policy, we will consult by the end of January 2004 the market on specific proposals to amend the Inland Revenue Ordinance to exempt offshore funds from profits tax, thus removing the earlier concerns of offshore fund managers. We will also continue to work with the industry to identify any other measures to increase our competitiveness as a major fund management centre in this region, such as co-operation with overseas regulators to allow easier access of international funds to our market.

8. In the banking area, we will strive to ensure the successful implementation of the scheme for providing personal RMB business by banks in Hong Kong. The scope of business includes RMB deposits, remittances, money exchange and RMB bank card business for individuals in Hong Kong. Under this scheme, participating banks will place the RMB funds absorbed from their depositors with a Clearing Bank appointed by the People's Bank of China for providing RMB clearing services in Hong Kong. This will provide a new channel for the flow of RMB funds between Hong Kong and the

Mainland through the banking system, which will in turn facilitate the growing economic co-operation between the two places.

9. To promote Hong Kong as an international financial centre and the premier capital formation centre for China, the Secretary for Financial Services and the Treasury (SFST) visited major financial centres in Europe in July 2003 and met with a wide cross-section of the European financial community, including our international counterparts and key contacts in the financial services sector, to update them on the latest developments in Hong Kong and reinforce the city's image as an IFC. To strengthen co-operation in financial services with the Mainland which will continue to be a key growth driver of our financial market, SFST led a delegation of the industry representatives to the Pearl River Delta in August 2003. We have also participated, in collaboration with market players, in the organisation of promotional activities led by relevant parties, such as the Office of the Government of the Hong Kong Special Administrative Region in Beijing – e.g. Fujian-Hong Kong Week in August 2003, Beijing-Hong Kong Financial Co-operation Forum in October 2003 and Zhejiang-Hong Kong Week in November 2003. These promotional efforts will continue.

Market Infrastructure

10. We are overseeing the implementation of a series of measures to improve market infrastructure to enhance the security, integrity, diversity and efficiency of settlement and clearing systems for securities and funds.

11. Specifically, to enhance the general safety and efficiency of the clearing and settlement systems and provide legal protection to transactions effected through such systems, we will devise new legislation to provide for a formal regulatory regime and for settlement finality in such systems. The relevant bill has been introduced to the Legislative Council (LegCo), and if enacted, would help bring the HK dollar into the international Continuous Linked Settlement (CLS) System, which is a global clearing and settlement

system for cross-border foreign exchange transactions. This will attract more investors to conduct their transactions in HK dollar.

Protection of Investors/Depositors

12. In parallel with our efforts on other fronts, we have not lost sight of the importance of protecting small investors/depositors. In 2003, we introduced the Deposit Protection Scheme Bill into the LegCo. We and the Hong Kong Monetary Authority are working together with the relevant Bills Committee to facilitate early enactment of the Bill. The proposed legislation would provide full protection to 84% of depositors in Hong Kong and enhance the stability of the banking system.

13. The Office of the Commissioner of Insurance (OCI) has launched in December 2003 the public consultation on the feasibility of establishing insurance policyholders' protection funds (PPF) in Hong Kong. The consultation exercise would be completed in March 2004. As we have emphasised on previous occasions, the Government keeps an open mind on the PPF concept, and will carefully consider the views received during the consultation, in particular those from the insurance industry, before taking a view on the way forward.

14. The Mandatory Provident Funds (MPF) Schemes Authority, together with the industry bodies, is working on new standards regarding the disclosure of fees and charges, and performance of MPF funds. The first set of new standards is expected to be ready by the middle of 2004. Their implementation would ensure greater transparency of MPF funds and better protection of MPF scheme members.

2003 Policy Agenda

15. We would like to also report in this note the progress made/present position in respect of our initiatives set out in the 2003 Policy Agenda. In a nutshell, Hong Kong has further consolidated its position as a major IFC. In

this regard, the facts speak for themselves. As at the end of November 2003, our stock market ranked 8th in the world and 2nd in Asia. We are also the world's 7th largest centre for foreign exchange trading. Virtually all major banks and insurers in the world have business operations in Hong Kong. The financial services sector remains a key element of our roadmap towards a competitive and vibrant economy.

16. The following sets out the progress made/present position of our new initiatives in the 2003 Policy Agenda -

(a) Upgrading corporate governance

- In January 2003, we together with the SFC and the HKEx reviewed the measures proposed by concerned parties to improve corporate governance and formulated the Corporate Governance Action Plan to identify priority areas, assign ownership and devise a timeframe for implementation. The priority areas identified are upgrading the listing rules and listing functions; tightening the regulation of initial public offer (IPO) intermediaries; effective roll-out of the Securities and Futures Ordinance (SFO); successful completion of the SCCLR Phase II Corporate Governance Review; and early implementation of SCCLR's recommendations from its Phase I Corporate Governance Review. We reported to this Panel the progress in the implementation of the Action Plan on 6 November 2003.

(b) Enhancing investor protection

- A new Investors Compensation Fund has been introduced for the securities and futures market since commencement of the SFO in April 2003.
- The Deposit Protection Scheme Bill was introduced into the LegCo in April 2003 and is now being scrutinised by the relevant Bills Committee.
- The OCI launched in December 2003 the public consultation on the feasibility of establishing PPF in Hong Kong.

(c) Facilitating the introduction of new products in the market

Examples of efforts made are –

- The SFC brought into effect various guidelines facilitating offers of shares and debentures (i.e. allowing awareness advertisements, introducing the “dual prospectus” mechanism and accepting for registration faxed copies of experts' consent letters and a bulk print proof of a prospectus) in February 2003. The relevant legislative amendments were included in the Companies (Amendment) Bill 2003, which is now being scrutinised by the relevant Bills Committee.
- In July 2003, after consulting the market, the SFC published the Code on Real Estate Investment Trusts (REITs).
- The SFC issued a consultation paper on Guidelines for Regulating Exchange Traded Funds under the Code on Unit Trusts and Mutual Funds in March 2003. The SFC has released the revised Guidelines on 24 October 2003.

FISCAL POLICY

Fiscal targets

17. In the 2003 Policy Agenda, we undertook to –
- (a) formulate an effective budget strategy with the objective of balancing the operating revenue and expenditure accounts by 2006-07. This would include levying a tax from early 2004 on passengers departing Hong Kong by land/sea in order to generate revenue to help finance improvement of boundary facilities; and
 - (b) implement measures to control growth in public expenditure in 2003-

04 to 2006-07 to ensure that the Budget is balanced and public expenditure is 20% of GDP or less by 2006-07.

18. In the 2003 Budget Speech, the Financial Secretary set out plans to reduce government operating expenditure by \$20 billion to \$200 billion in four years. We have implemented the first phase of the reduction through a 1.8% efficiency drive throughout the Government in 2003-04.

19. The 2003 Budget Speech also outlined a package of revenue-raising proposals totalling some \$14 billion. We have already secured nearly \$13 billion of this package. As for the remaining \$1 billion originally budgetted for the Boundary Facilities Improvement Tax, it is clear from discussions with the Legislative Council and other interested parties that the public is not yet ready to accept the tax. Accordingly, the Financial Secretary announced in October 2003 his decision not to proceed further with it at the current juncture.

20. As has also been explained, the outbreak of SARS in early 2003 had dealt a severe blow to the economy and made it unrealistic for Government to adhere to the target of balancing the budget by 2006-07. Taking into account community sentiments to allow the economy more room to breathe in the next year or two, Government has deferred the time line for achieving fiscal balance by two years.

21. In the 2004 Policy Agenda, we have undertaken to –

(a) implement measures to contain public expenditure in 2004-05 to 2008-09 to strive to achieve the target of restoring fiscal balance and keeping public expenditure to 20% of GDP or below by 2008-09; and

(b) continue to implement the asset sale and securitisation programme.

22. We are committed to controlling government operating expenditure and bringing it down to \$200 billion by 2008-09. On the operating revenue side, our aim is to attain \$200 billion by the same year. As part of the asset

sale and securitization programme, we have completed the sale to the Hong Kong Mortgage Corporation of civil service housing loans and the Home Starter Loan Scheme portfolio, raising proceeds of \$15.7 billion in 2003-04. We are also preparing to securitise revenue from the government toll tunnels and bridges and examining the feasibility of partial privatisation of the Airport Authority.

Efficiency Drive

23. We undertook in the 2003 Policy Agenda to enhance administrative efficiency and effectiveness of the Bureau through re-engineering, re-organisation and re-prioritisation of service delivery. We are pleased to report that we have successfully merged the former Government Land Transport Agency, Government Supplies Department and Printing Department into the Government Logistics Department from 1 July 2003 for eventual savings of about \$26.5 million per annum.

24. We are continuing the drive for efficiency and have just put forth a package of proposals to rationalise the directorate structure within the Financial Services and the Treasury Bureau and the Inland Revenue Department as from 1 April 2004, producing net savings of about \$1.3 million per annum in staff costs.

Financial Services and the Treasury Bureau

8 January 2004