

## **Speech by SFST at special meeting of LegCo Panel on Financial Affairs**

Friday, July 20, 2007

Following is the speech (English translation) by the Secretary for Financial Services and the Treasury, Professor K C Chan, at a special meeting of the Legislative Council Panel on Financial Affairs on July 20:

Mr Chairman, I would like to thank the Panel on Financial Affairs for inviting me to today's meeting. My colleagues in the Financial Services and the Treasury Bureau (FSTB), including the two Permanent Secretaries, and I are very glad to attend the meeting and the discussions of the Panel. We attach great importance to Members' views and hope that, through participation in the Panel meetings, we can enhance our communication and cooperation with Members.

I have prepared a set of PowerPoint for today's presentation. To give the Panel more time for discussion, I will not go through every slide in detail. However, I will elaborate on issues that may be of greater concern to you.

### Financial Services

First, I would like to talk about our work in financial services. Our policy goal is clear. It is to align our policies with the pledge of "building Hong Kong as China's International Financial Centre (IFC)" in the election platform of the Chief Executive (CE).

To achieve this goal, we will make greater efforts in continuing to facilitate market development and improve market quality, so as to attract more financial activities to Hong Kong.

### Facilitating Market Development

There are a total of seven policy initiatives in facilitating market development.

1. 11<sup>th</sup> Five-year Plan — Action Agenda

China's 11<sup>th</sup> Five-Year Plan clearly indicates support for developing Hong Kong's financial industry and maintaining Hong Kong's status as an IFC. The Action Agenda of the 11<sup>th</sup> Five-year Plan announced early this year made a total of 80 recommendations aiming to build Hong Kong as our country's IFC. Within a short space of half a year, about 30 of these recommendations have been implemented. We will continue to work closely with the industry and relevant organizations to follow up on the remaining recommendations.

## 2. Strengthening the financial cooperation between Hong Kong and the Mainland

As mentioned by the CE in his Policy Agenda, while our financial industry has made great strides in the past few years, the challenges that lie ahead are increasingly severe. The major deficiency of Hong Kong is our comparatively small local economy. Our important strategy, therefore, is to further our economic integration with the Mainland.

To create a win-win situation, we need to develop not only a "complementary", "cooperative" and "interactive" relationship with the Mainland financial system, but also a "three-level" "complementary", "cooperative" and "interactive" relationship, which includes:

- (1) at "political" level involving top-level government officials;
- (2) at "decision-making" level involving the financial regulators of the two places; and
- (3) at "working" level involving the frontline institutions and the financial industries of the two places.

One of our future programme highlights is to strengthen financial cooperation with the Mainland and actively develop the "three-level" "complementary", "cooperative" and "interactive" relationship with our counterparts in the Mainland.

### (3) Consolidating Hong Kong's position as Asia's leading Asset Management Centre

In the past year, we have abolished the estate duty and exempted offshore funds from profits tax. These measures have begun to bear fruits. According to the survey figures announced by the SFC yesterday, Hong Kong's asset management business amounted to HK\$6,154 billion at the end of 2006, representing a substantial increase of 36% over 2005 and an accumulative growth of over 70% in the past two years.

We are optimistic about the prospect of Hong Kong's asset management business. With Mainland's rapid economic expansion and growth in personal savings in recent years, the demand for investment products and wealth management in the Mainland has increased significantly. The launch of QDII reflects the need for the Mainland authorities to facilitate the outflow of capital in an orderly manner. In this respect, Hong Kong is in the best position to become the premier asset management centre for the Mainland.

I would like to emphasize that this is another complementary development that can meet the development needs of the country on the one hand, and further consolidate Hong Kong's position as an asset management centre on the other.

We are very glad to see that the China Banking Regulatory Commission and the China Securities Regulatory Commission have, in recent months, announced the further expansion of the scope of QDII to allow Mainland banks, securities companies and fund management companies to invest in products such as stocks and funds in Hong Kong. In addition, the Supplement IV to CEPA signed at the end of last month further allows Mainland fund management companies to set up branches in Hong Kong.

We understand that there are nearly 60 eligible companies. As many as 20 of these will hopefully become the first batch of fund companies allowed to set up branches in Hong Kong. They will not only help channel Mainland funds to Hong Kong, but also further strengthen Hong Kong's financial industry and create more business and job opportunities.

#### (4) Broadening the source of listed companies

On the listing arrangements, we will not only attach importance to the Mainland market, but also develop an international outlook in an effort to facilitate the listing of more quality foreign enterprises in Hong Kong.

#### (5) Enhancing bond market development

The SAR Government will continue to facilitate the development of bond market, adopting measures including provision of the necessary financial infrastructure.

## (6) Expanding Renminbi (RMB) business

The SAR Government will continue to strive for the expansion of RMB business in Hong Kong, which includes the plan to allow Hong Kong importers to settle in RMB the accounts of direct imports from the Mainland. We are very pleased to see that the first RMB bond issuance was successfully launched at the end of last month.

## (7) Promoting Hong Kong as an IFC

In the past year, the FSTB, together with the Hong Kong Exchanges and Clearing Limited (HKEx), the Trade Development Council and industry players visited a number of Mainland cities and overseas countries to launch promotional activities and hold financial cooperation discussions. In the coming year, we will continue our work in this respect.

We are also preparing to stage an Asian Financial Forum on September 21. Senior government officials and distinguished leaders of the financial services sector from around the world will gather together at the forum, which will help raise the international status of Hong Kong's financial industry.

## Improving Market Quality

We also have a total of seven policy initiatives to improve market quality.

### 1. Enhancing corporate governance and financial reporting

Good corporate governance is the cornerstone of Hong Kong as an IFC. We will continue to maintain close cooperation with all regulators and strive to enhance the corporate governance standard of Hong Kong companies.

One of the important measures to enhance the corporate governance of listed companies is to strengthen the regulation of accounting profession in Hong Kong and raise the quality of financial reporting of listed companies. The Financial Reporting Council (FRC) has been operational since early this week. We will render full support and assistance to the FRC.

### (2) Enhancing investor protection and education

In respect of investor protection, apart from improving corporate governance as mentioned earlier, we have in place an effective system to supervise brokers' operation and risk management.

Over the past few years, the Administration and the SFC have also made great efforts to improve our system. However, I have also noticed that the public and the Legislative Council have shown continued concern over these issues. I am also aware of the public expectations of the level of investigation and time taken by the SFC to deal with market misconduct. We will request the SFC to exert greater efforts to ensure that investors are adequately protected.

Good investor education not only affords protection to investors personally, but also has a positive effect on the stability of Hong Kong's financial industry as a whole and on boosting international investors' confidence in the Hong Kong market.

In last year's Budget, the former Financial Secretary mentioned that the SFC would explore ways of utilising part of its levy income to enhance investor protection and education. Over the past few months, the SFC and the other financial regulators have begun their study in this respect. We will continue to support and facilitate their work.

### (3) Improving market efficiency

In enhancing investor protection, we also have to strike a balance in regulation so as not to stifle market development.

Over the past year, the SFC and the HKEx have implemented a number of recommendations to increase market efficiency. For example, the position limits of H-shares index futures and options contracts were raised and the licensing procedures for overseas fund managers streamlined early this year. The regulators will continue to review the regulatory systems, framework and licensing regimes to achieve excellence. The Administration will also continue to render them support and assistance.

## 4. Improving operation of MPF system

I am aware that members of the public are very concerned about the operation of the MPF system as well as the types and levels of charges of MPF funds. I am equally concerned about these issues. I am very pleased to learn that these issues have received great attention by the MPFA Chairman.

#### Fees and charges of MPF funds

I know that the MPFA and the industry are discussing feasible options to allow employees to choose their own trustees, which I consider conducive to promoting competition among the trustees, thereby achieving the purpose of reducing the fees and charges. I hope that the MPFA can reach an early consensus with the industry on the details of the options and submit a detailed proposal to the Government for consideration.

I also fully support the MPFA in exploring feasible means as soon as possible to offer more choice of low-fee MPF products so as to increase market competition, thereby lowering the fees and charges of MPF funds.

#### Proposal to increase penalties

I agree that the MPFA should step up its enforcement measures against employers who willfully evade or default on MPF contributions. The MPFA has recently proposed to the Government to increase penalties so as to combat the offences by employers of failing to register or make MPF contributions for their employees. The MPFA hopes that the existing penalties for first conviction of a maximum fine of \$100,000 and imprisonment for six months will be raised to a maximum fine of \$350,000 and imprisonment for three years so that the penalties will be on a par with those for non-payment of wages under the Employment Ordinance.

We are actively considering the MPFA's proposal to increase penalties and will seek the advice of the Department of Justice. Members' views on this proposal are welcome.

#### 5. Providing statutory backing for major listing requirements

We attach great importance to the views of regulators and the industry on the legislative proposal to provide statutory backing for major listing requirements. We intend to further consult the market on the proposed details of the legislation.

## 6. Implementing Basel II

Basel II has been implemented since January this year. The HKMA will continue to monitor its implementation by the industry.

## 7. Rewriting the Companies Ordinance

Phase one of rewriting the Companies Ordinance began in the middle of last year. We will continue with the work in the coming year, and plan to issue a White Bill to consult the public in 2009.

### Management of Public Finances

Next, I would talk briefly about our work on public finances.

Our policy goal is to maintain sound and healthy public finances for Hong Kong. A sound and healthy system of public finances is one of our major economic edges. There are three principles of the policy, which are continuing to maintain strict financial discipline and keeping expenditure within the limits of revenue, making efficient use of public finances, and adhering to a low and simple tax regime. On the other hand, public finances permitting, we will respond as far as possible to calls from various sectors of the community for increased government expenditure, poverty alleviation and tax concessions, and meeting future challenges.

### Broadening the Tax Base

A simple and low tax system has all along been an important factor of our success. To remain competitive in the region, we must maintain this major advantage. As you all know, our tax base is very narrow. To effectively improve our public finances so as to meet future challenges brought by the rapidly aging population, globalisation, etc, there is a real need for us to broaden the tax base.

In July last year, the Government launched a public consultation on “Broadening the Tax Base”, which lasted nearly nine months. Following this consultation, the public generally agrees that the problem of narrow tax base exists in Hong Kong and that the problem needs to be addressed.

## Way Forward

Although the public does not have any clear inclinations or mainstream views on which option to be adopted to broaden the tax base in the public consultation, our work will not end there. We will take into full account the views collected in the consultation exercise and continue to study various options for broadening the tax base. In considering the introduction of any new tax, the Government will study carefully the impact of the tax on the economy and people's livelihood and listen extensively to the views of the public and professionals.

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