

Speech
Keynote speech by SFST at Hong Kong Trustees' Association Conference
(English only)

Tuesday, October 31, 2017

Following is the keynote speech by the Secretary for Financial Services and the Treasury, Mr James Lau, at the Hong Kong Trustees' Association Conference today (October 31):

Michael (Chairman of the Hong Kong Trustees' Association, Mr Michael Shue), Ka-shi (Vice Chairman of the Hong Kong Trustees' Association, Ms Lau Ka-shi), ladies and gentlemen,

Good morning. I am delighted to join you all today at the Hong Kong Trustees' Association Conference.

When we do the pitching for Hong Kong as an international financial centre, we may talk about our banking sector, Initial Public Offerings (IPOs), asset management and so forth. The trust industry is unlikely to feature and grab the headlines. But all of us here know that trusts are actually the underlying structure for many financial products such as Exchange-Traded Funds (ETFs), Mandatory Provident Fund (MPF) schemes and funds, and private and charitable trusts. The trustees therefore form a key backbone of the financial professionals in Hong Kong. The Government and regulators interact with the trust industry in a variety of ways. Today I would like to cover five areas, the facilitation of market development, enhancement of market infrastructure, professional and talent development, international regulatory compliance and supportive tax policy.

Let me begin by speaking about our efforts to facilitate market development through the Mutual Recognition of Funds (MRF) arrangements. Over the years, the SFC has entered into arrangements with the Mainland and several other jurisdictions to expand the distribution network for Hong Kong's fund management industry and further the development of our asset management industry. The Mainland-Hong Kong MRF was launched in July 2015, and the SFC concluded MRF with Switzerland in December 2016 and then with France in July 2017. For a fund to qualify under these initiatives, it must be an SFC-authorized fund domiciled in Hong Kong and managed by an

SFC-licensed fund manager, also based in Hong Kong.

Traditionally, Hong Kong's asset management industry has been dominated by sales and marketing professionals, which make up 70 per cent of its workforce. It has been said that Hong Kong is arguably more a fund management centre but less a fund centre. However in recent years, we have seen increasing activities and employment in fund domicile, administration and accounting that are driven by the growth of Hong Kong-domiciled funds. The number of Hong Kong-domiciled SFC funds grew from 422 five years ago to 735 in March 2017, such that the percentage of Hong Kong domiciled funds in relation to all SFC authorised funds has increased from 21 per cent five years ago to 33 per cent today. That is a significant move but I do not think we should be complacent here. I suppose the MRF arrangements constitute a positive factor behind the growth of Hong Kong domiciled funds and we will continue our work on this front.

Another focus has been on the development of the ETF market in Hong Kong. ETFs are transparent, liquid and low cost products, and are particularly useful for accessing new markets or new asset classes. To promote a vibrant and diversified ETF market, the Government waived the stamp duty for the transfer of all ETFs starting from February 13, 2015. Leveraged and inverse products and smart beta ETFs have also been launched in Hong Kong. The Mainland-Hong Kong MRF arrangements cover physical index-tracking ETFs, and as many as 75 constituent funds under the MPF schemes have investments in ETFs listed in Hong Kong. These are all encouraging developments helping to promote the growth of the ETF market in Hong Kong. We are also pursuing the possibility of including ETFs in the mutual market access mechanism between Hong Kong and the Mainland.

On enhancement of market infrastructure, may I focus on eMPF, or more precisely, the centralised electronic administrative platform to enhance the efficiency of the MPF system as a whole. I am sure that Dr David Wong, the Chairman of the Mandatory Provident Fund Authority (MPFA), will speak more on this subject at today's luncheon keynote speech. I would just emphasise that the Government takes this centralised platform as a priority because we believe that it will reduce the administrative and regulatory burden on MPF trustees and at the same time create more room for fee reduction to enhance public trust and confidence in the MPF system. In other words, we

believe that it will be a win-win scenario for the trustees, users, the Government and of course the MPFA.

Building such a piece of infrastructure is by no means easy. It is not an IT project as such but a complicated change management process to make MPF better and more efficient. There are many issues to be sorted out by the Working Group on eMPF among the Government, the MPFA and trustees. Today, I wish to highlight three areas concerning this centralised platform.

First, we are mindful that the centralised platform must be able to reduce the administrative and regulatory burden on trustees. I understand that MPF trustees have been working diligently with us to draw up the Technical Specifications for this platform and our target is to have it done by August 2018. The specifications will provide us with a solid base for the scoping of the project, cost analysis, detailed transition planning, and delineating the respective roles and responsibilities of trustees vis-à-vis the centralised platform under this eMPF environment. The last point – delineation of roles and responsibilities – is very important. Based on the agreed delineation, we can work out the corresponding legislative amendments that will reduce the administrative and regulatory burden on trustees. I am delighted to learn from my colleagues that trustees have been very helpful in developing the Technical Specifications. And my colleagues will start taking stock of the necessary legislative amendments on reduction of the regulatory burden in parallel.

The second area is by whom and how will the centralised platform be operated? On this issue, I understand that there have been some discussions among the Government, the MPFA and trustees from the very beginning. To answer this question, I would like to invite you to go to the basics. That is, the centralised platform will be a huge database containing the information of \$700 billion worth of assets in nine million MPF accounts owned by almost four million scheme members. Such a piece of infrastructure needs substantial public participation and ownership for securing public trust and confidence. By "ownership", I am referring to ownership not just of the physical infrastructure, but ownership of responsibilities in ensuring its reliability, security and integrity. I cannot imagine that this project can be a purely private initiative. However, if operationally justified, we welcome options such as co-ownership of the infrastructure and responsibilities to secure its smooth transition and operation with the private sector.

And the third point here is whether a transition from the existing scheme-based system to a fund-based system will be a more ideal model. And if so, should it happen in conjunction with the transition from a decentralised administration environment to a centralised platform? I understand some trustees have floated this idea for discussion with the Government and the MPFA. Let's go back to the basics again.

If a fund-based MPF system means that the private sector service providers in the MPF universe are only fund providers and a central entity will take up all the administration and legal responsibilities in relation to the operation of a long-term retirement savings scheme, we should be able to maximise operational efficiency due to this division of labour. To maximise the economies of scale as well, I envisage that one will only need a handful of funds such as the Default Investment Strategy, a high risk fund, a low risk fund and a highly liquid money market fund. Very tempting but there might have significant implications for the industry.

The unfortunate reality is that we are not starting with a clean slate. Moving \$700 billion worth of assets in over 400 MPF Constituent Funds held in nine million accounts owned by almost four million scheme members to the "Brave New World" will add a whole range of legal and operational issues of dissolving trusts and amalgamating funds to the challenges of building the centralised platform, which is by itself already a very complicated process. This doesn't mean that we are not ready to think big. We are very careful in balancing the ideals, scheme-based to fund-based, with the practicality and industry implications. Nevertheless, we will welcome practical ideas from the industry that will make the future MPF system empowered by a centralised platform work better.

A third area I would like to address is how the Government supports professional and talent development in the asset and wealth management sector, including the trust industry. In order to enhance talent training for the asset and wealth management sector, the Government launched a three-year pilot programme in August 2016 with a budget of around \$43 million. One of the initiatives is to provide subsidies for financial services practitioners to participate in certain qualified training courses. New courses are being added to the eligible course list such that more practitioners may benefit from the pilot

programme. For me, I would like to encourage the asset and wealth management and trust industry to make good use of this pilot programme. I must thank the HKTA of course because one of these new courses is offered by you. I must thank you for your support and I hope we can see more leverage on the resources provided here in order to encourage more people to join the trust industry. This is a three-year programme and in two more years we will be reviewing, so your use of the programme will provide justifications for it to be continued or scrapped.

Speaking of HKTA's support, I should recognise your efforts to reach out to students as well. Thanks to your promotion and the support of members here, we have provided internship opportunities to a good number of undergraduate students in several trust companies under the pilot programme. When we talked about job or career opportunities in the financial services industry in career days, very often we talked about investment banking, accountancy or asset management, very seldom we touched on the trust industry. In future we should invite one of you to volunteer to talk in the career day organised by the Financial Services Development Council.

The fourth topic today relates to the importance of ensuring compliance with various international standards. Amidst global efforts to combat money laundering and terrorism, it is incumbent upon Hong Kong, as a member of the Financial Action Task Force (FATF), to implement the relevant international regulatory standards on anti-money laundering (AML) and counter-terrorist financing (CTF). As you know, the Government has introduced a legislative proposal to establish a licensing regime for trust or company service providers (TCSPs). We are conscious of the additional compliance efforts but this is necessary to meet international standards relating to the integrity of the AML or CTF regulatory regime in Hong Kong.

The amendment bill is currently under the scrutiny of LegCo. As Hong Kong is scheduled to undergo a mutual evaluation by the FATF in 2018/19, I hope that LegCo will pass the bill as soon as possible so that the TCSP licensing regime can come into operation on March 1 next year for us to reinforce Hong Kong's credibility in honouring our FATF commitments. We will continue to work closely with the HKTA and render all assistance to facilitate the trade in the migration to the new regulatory regime.

The last topic I would like to cover concerns the Government's tax policy. Much has been said about how we support the development of the asset management sector. We do recognise one important point, the negotiation of comprehensive avoidance of double taxation agreements (CDTA) with our key trade partners. The Government has so far concluded CDAs with 38 tax jurisdictions. I would caution that CDA negotiation is not a straightforward task for Hong Kong. Given our territorial-based tax regime, some overseas jurisdictions which adopt a worldwide tax system do not have a strong desire to sign CDAs with Hong Kong because double taxation is not a significant concern for their residents. The room for Hong Kong to offer favourable treaty terms as bargaining chips is also limited given our simple and low tax regime. While we are committed to increasing the number of CDAs, this task has become increasingly challenging because of new norms in international tax co-operation. The Multilateral Convention on Mutual Administrative Assistance in Tax Matters now serves as an international platform to make the automatic exchange of tax information a mandatory requirement amongst different jurisdictions. Therefore, the incentive for tax authorities to obtain tax information from each other through concluding bilateral CDAs has significantly diminished. But we will continue our efforts in this area, especially with our major trading partners and with economies along the "Belt and Road."

As part of the Government's efforts to explore new tax policies to support economic development, the Government held a Tax Summit on October 23, 2017 on "New Directions for Taxation". It is notable that Pascal Saint-Amans, Director of the Centre for Tax Policy and Administration of the Organisation for Economic Co-operation and Development (OECD) spoke about the reputational risk for Hong Kong if we are late in complying or being outright non-compliant with international standards. Indeed, as much as we support asset management through appropriate tax measures, it is equally important to avoid "harmful tax practices", such as tax schemes that attract financial and other geographically mobile activities, create harmful tax competition between jurisdictions, carry risks of distorting trade and investment, and lead to the erosion of national tax bases.

As an example, for our tax regime for aircraft leasing that was introduced in mid-2017, we implemented a half-rate tax concession for qualifying aircraft lessors and qualifying aircraft leasing managers with central management and

control in Hong Kong. This is in respect of profits derived from qualifying aircraft leasing activities and qualifying aircraft leasing management activities undertaken in Hong Kong. In this case, we had to amend the legislative proposal midway to remove any suggestion of a ringfencing arrangement.

Ladies and gentlemen, to conclude, the diverse range of trust funds and products forms the backbone of the asset management industry in Hong Kong. The Government will continue to work closely with the industry and your Association to promote industry growth while fulfilling our international obligations, and maintaining a high standard of regulatory compliance. Thank you.

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