立法會
Legislative Council

LC Paper No. CB(1) 1951/00-01
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Ref : CB1/PL/FA/1

Legislative Council
Panel on Financial Affairs

Minutes of Meeting held on
Tuesday, 3 July 2001 at 10:45 am
in the Chamber of the Legislative Council Building

Members present	**:**	Hon Ambrose LAU Hon-chuen, GBS, JP (Chairman) Hon Henry WU King-cheong, BBS (Deputy Chairman) Hon James TIEN Pei-chun, GBS, JP Hon LEE Cheuk-yan Hon Eric LI Ka-cheung, JP Dr Hon David LI Kwok-po, GBS, JP Hon NG Leung-sing, JP Hon James TO Kun-sun Hon Bernard CHAN Hon CHAN Kam-lam Hon SIN Chung-kai Hon Jasper TSANG Yok-sing, JP Hon Emily LAU Wai-hing, JP
Members absent	**:**	Hon Albert HO Chun-yan Dr Hon Philip WONG Yu-hong

Public officers attending	**:**	<u>For Item IV</u> Miss Denise YUE Secretary for the Treasury Mr Stanley YING Deputy Secretary for the Treasury <u>For Item V</u> Miss Maureen TO Principal Assistant Secretary for Financial Services Mr Benjamin TANG Commissioner of Insurance Mr Ros K T LAM Assistant Commissioner of Insurance
Attendance by invitation	**:**	<u>For Item IV</u> Prof Y C JAO Honorary Professor, School of Economics & Finance, The University of Hong Kong Prof HO Lok-sang Director, Centre for Public Policy Studies, Lingnan University Prof Terence CHONG Associate Professor, Department of Economics, The Chinese University of Hong Kong Prof TANG Shu-hung Head/Professor, Department of Economics, Hong Kong Baptist University

Prof Wilson WONG Wai-ho
Assistant Professor, Department of Government & Public Administration, The Chinese University of Hong Kong

Prof Stephen Y L CHEUNG
Professor, Department of Economics & Finance, City University of Hong Kong

Prof Francis LUI Ting-ming
Professor/Director of Centre for Economic Development, Hong Kong University of Science and Technology

Clerk in attendance : Mrs Florence LAM
Chief Assistant Secretary (1)4

Staff in attendance : Ms Connie SZETO
Senior Assistant Secretary (1)1

I Confirmation of minutes of previous meeting
(LC Paper No. CB(1) 1460/00-01)

The minutes of the meeting held on 7 March 2001 were confirmed.

II Papers issued since the last meeting
(LC Papers No. CB(1) 1540/00-01 and 1606/00-01)

2. Members noted that two information papers had been issued since the last meeting.

Draft Report on the Financial Systems in the United Kingdom and the United States of America
(LC Paper No. CB(1) 1570/00-01)

3. Members endorsed the draft report and noted that this would be tabled at the meeting of the Council on 4 July 2001.

4. Miss Emily LAU said that the chapter on "Consumer Protection" of the captioned report provided a useful overview on measures adopted by the two countries to protect the interests of consumers. Noting that the Research and Library Services Division of the Legislative Council Secretariat was conducting a research into the protection of interests of banking consumers in the UK and the US, Miss LAU suggested, and members agreed, that the Panel should pursue the subject in the coming session. She also suggested that the Administration should be invited to respond to the research report when it was available.

Procurement of large saloon cars
(LC Paper No. CB(1) 1641/00-01)

5. According to the information paper provided by the Administration, Miss Emily LAU noted that a tender exercise for the procurement of large saloon cars had closed in mid-June and that the assessment would be completed by August/September 2001. She suggested that the Administration should be requested to inform the Panel of the outcome of the tender exercise. FB

Report of the Hong Kong Special Administrative Region of the People's Republic of China in the light of the International Covenant on Economic, Social and Cultural Rights
(LC Paper No. CB(2) 1930/00-01)

6. Miss Emily LAU said that the Committee on Economic, Social and Cultural Rights had referred to the substantial fiscal reserves held by the HKSAR Government in the Concluding Observations. She reiterated her earlier suggestion that the Government should consider utilizing the reserves to fund new initiatives to improve the livelihood of the general public.

III Panel Report for 2000-01 for submission to the Legislative Council
(LC Paper No. CB(1) 1646/00-01(02))

7. Members endorsed the draft Panel report for 2000-01 and noted that this would be tabled at the meeting of the Council on 11 July 2001.

IV Proper use of fiscal reserves
(LC Papers No. CB(1) 1625/00-01(01)-(06), 1646/00-01(03)-(09), 1691/00-01(01), and 1750/00-01)

8. The Chairman welcomed the academics to the meeting and invited them to present their views. Members noted that the written submissions provided by various academics had been circulated before the meeting. Members' deliberations were summarized in the following paragraphs.

(*Post-meeting note*: (a) Presentation material provided by Professor Stephen Y L CHEUNG was circulated to members under LC Paper No. CB(1) 1691/00-01 on 4 July 2001.

(b) A written submission provided by Professor Francis LUI Ting-ming was circulated to members under LC Paper No. CB(1) 1750/00-01 on 10 July 2001.)

The purposes of fiscal reserves

9. Pointing out that the primary objective of the Exchange Fund (EF) was to maintain the stability of the Hong Kong dollar, some members questioned whether there was any need to maintain the fiscal reserves at the current level in order to defend the Hong Kong dollar. Miss Emily LAU considered that as the seven technical measures introduced by the Hong Kong Monetary Authority in 1998 had helped to strengthen the currency board system, it seemed that there was no justification to maintain a large fiscal reserve to defend the Hong Kong dollar.

10. In response, Professor Y C JAO said that as Hong Kong was a small and open economy, it was vulnerable to external shocks. A large fiscal reserve would act as a buffer against extreme adverse effects which might be brought about by an unanticipated financial crisis. Hong Kong's experience during the Asian Financial Crisis illustrated the importance of having ample reserves.

11. While sharing Professor JAO's view, other academics considered that the current level of EF should be able to provide full backing for the Hong Kong dollar. They were concerned about the high opportunity cost to Hong Kong for preserving a huge fiscal reserve to maintain the stability of Hong Kong dollar. Professor HO Lok-sang said that the stability of the Hong Kong dollar also depended on the exchange rate set under the Linked Exchange Rate system. The exchange rate of HK$7.8 to US$1 had remained stable in the past two years. This

reflected the confidence in the Hong Kong dollar. Professor LUI Ting-ming opined that instead of preserving the fiscal reserves to maintain the stability of Hong Kong dollar, the reserves could be used to improve the economic environment, which in turn would help maintain the stability of the exchange rate.

The adequacy of fiscal reserves and the formula for determining the appropriate level

12. Some members considered that the guidelines for determining the level of fiscal reserves, announced by the Financial Secretary in his 1998-99 Budget Speech (1998 guidelines), was to rationalize the retention of the substantial amount of public money under the fiscal reserves. They questioned whether there was any practical need to prescribe a formula or a guideline to determine the appropriate level of fiscal reserves.

13. Professor LUI said that the establishment of a guideline on the fiscal reserves would enhance the transparency and credibility of the Government's fiscal policy. Nonetheless, it might be necessary to preserve a certain degree of constructive ambiguity in the Government's fiscal position to prevent speculation on the currency. Professor TANG Shu-hung concurred that a reasonable guideline would prevent the Government from adopting a conservative policy in fiscal management.

14. Professor JAO considered that the 1998 guidelines, which set the level of fiscal reserves at the sum of 12 months' government expenditure and Hong Kong dollar money supply under the M1 definition, were acceptable. However, as the guidelines allowed a range of plus or minus 25% which provided considerable leeway to the Government, Professor JAO suggested that the range should be reduced to plus or minus 5%. Any amount beyond the upper limit could be regarded as "freely disposable fiscal reserve". Professor Stephen CHEUNG agreed that flexibility should be provided in the guidelines. He suggested that the ratio of reserves-to-Gross Domestic Product could be used as a benchmark in measuring the adequacy of the reserves. Lower and upper limits could be set to reflect the short-term fluctuations in the economy. Excess reserves should be invested in projects which would enhance Hong Kong's sustainable economic growth. Professor TANG considered that the 1998 guidelines were too conservative. He suggested adopting a ratio of reserves-to-expenditure as the guideline for fiscal reserves. At the beginning of a financial year, the level of reserves should be sufficient to cover 50% of the Government's expenditure for the year. Professor Wilson WONG said that it would be sufficient for the Government to maintain the level of fiscal reserves at 12 months' public

expenditure. If necessary, the Government could borrow money from the market to meet any shortfall in expenditure.

15. As to whether the Government should utilize the accumulated fiscal reserves to improve the livelihood of the general public and to stimulate the economy, Professor HO said that the Government should adopt a stable fiscal policy with the objective of maintaining a balanced budget at full employment. However, he supported the view that the Government should increase its spending for worthwhile purposes, such as investing in social projects with a good rate of return. Professor HO further remarked that the Government should tolerate cyclical budget deficits but not structural deficits. He was worried that the problem of successive operating deficits in the Government budget in recent years was structural in nature. He urged the Government to review its housing policy so as to revitalize Hong Kong's property market and to increase its land-based revenues, thus alleviating the problem of structural deficits. Professor TANG, on the other hand, was of the view that the Government should utilize the substantial reserves to improve the economy and to invest in projects for the long-term benefits of Hong Kong. On the problem of budget deficits, Professor TANG remarked that the Government should review its taxation system to consider whether a broader-based tax system should be introduced in order to increase government revenues.

Suggestions on use of fiscal reserves

16. On principles which the Government should take into account in investing the fiscal reserves, Professor WONG said that the Government should avoid making long-term financial commitments which might undermine the strength of public finances in the long run. Secondly, the Government should use the excess reserves to provide public services through the private sector, as this would improve overall cost-effectiveness. Furthermore, the spending should be focused on investment items rather than consumption items as the former would yield returns for the society. Professor LUI said that the Government should invest the reserves to enhance the productivity and competitiveness of Hong Kong. Investments made should help alleviate the problem of uneven distribution of wealth and provide benefits to the entire society rather than particular classes of people. The investment should best be undertaken by the private sector. Professor CHEUNG opined that the reserves should be invested in projects that would enhance Hong Kong's sustainable economic growth. Projects should generate a higher rate of return than that of EF. For example, infrastructure projects to improve the hardware and software for economic development would attract more investments to Hong Kong. Nevertheless, he agreed that it would be difficult to determine the rate of return for projects. For instance, social stability

brought about by social assistance programmes could not be quantified in monetary terms.

17. In respect of specific investment programmes, Professor Terence CHONG suggested that the Government should utilize the excess reserves to set up a Relief Fund. The interest income generated by the Fund could be used to help the low-income groups. Professor LUI suggested that the Government should earmark about HK$200 billion to set up a tertiary education fund for the long-term development of tertiary education in Hong Kong. Professor WONG concurred that investment in education programmes would bring about long-term benefits for Hong Kong. He suggested that an endowment fund could be created to privatize the universities in Hong Kong. University education should be self-financing and should not depend on government recurrent funding. Professor JAO suggested that the excess reserves could be utilized according to the following priorities: training and retraining programmes for the unemployed and under-employed, social security assistance programmes, education and development of high technology, and tax cut.

18. The Chairman thanked the academics for attending the meeting.

V Issues relating to the monitoring of the financial position of insurance companies and the compensation arrangements for insurance policy holders

(LC Papers No. CB(1) 1646/00-01(10) and 1691/00-01(02))

19. The Commissioner of Insurance (C of I) took members through the presentation material which was tabled at the meeting. He explained the work of the Office of the Commissioner for Insurance in monitoring the financial position of insurance companies and the compensation arrangements for policy holders in the event of liquidation of an insurer.

20. Responding to Mr James TIEN's enquiry about the position of authorized insurers in Hong Kong, C of I advised that as at 31 May 2001, there was a total of 207 authorized insurers in Hong Kong over half of which were incorporated overseas. The presence of a large number of overseas insurers was due to the fact that there was no barrier for entry into the local insurance market. According to the Insurance Companies Ordinance (ICO) (Cap. 41), any company interested in carrying out insurance business in Hong Kong could apply to the Insurance Authority (IA). The ICO stipulated the requirements for authorized insurers which included minimum requirements on paid-up capital and solvency margin, fitness and properness of the management, and adequacy of reinsurance

arrangements. C of I added that there was a growing trend of consolidation in the insurance industry. Over the past few years, the number of authorized insurers had declined from more than 300 to the present position.

21. Referring to the winding up of three local insurers in April 2001 as a result of the liquidation of their parent company in Australia, Mr LEE Cheuk-yan expressed concern about the difficulty for the IA to monitor the financial position of overseas parent companies of local insurers.

22. C of I advised members that the petition to the court to wind up the insurers had been made to enable the provisional liquidators to be appointed to take full control of the insurers to ensure that their assets were preserved to meet their liabilities. The IA would also work with the provisional liquidators to ensure that the business of the insurers was properly managed in the best interest of the policy holders. Since the petition, the IA and relevant industry bodies had been liaising closely to assist the affected policy holders in matters relating to policy replacement and compensation arrangements.

23. As to the monitoring of the financial position of overseas insurers, C of I said that the IA had been maintaining close contact with overseas regulators. There was sharing of information relating to the activities and financial position of local insurers and their parent companies. Hence, the IA was able to take swift action in early April 2001 in respect of the three insurers when their parent company in Australia went into provisional liquidation in mid-March 2001.

24. Noting that the local insurance industry had become more competitive, Mr Eric LI said that there had been a significant increase in the number of claims. He expressed concern about an increasing systemic risk in the market and asked whether the IA would consider reviewing the minimum solvency margin to be maintained by insurers.

25. C of I said that the general insurance business, such as property damage and general liabilities, had become increasingly competitive in recent years. The IA exercised prudential supervision over authorized insurers on a continuing basis through examination of business returns and reports, and regular on-site inspections of the insurers. When there was doubt about an insurer’s ability in complying with the capital and solvency requirements, the IA would place it under the "Watch List" where the insurer would be subject to enhanced monitoring and supervision. Where appropriate, C of I would exercise his powers of intervention which included restriction on new business to be taken up and putting the insurer's assets under the custody of a trustee. In order to monitor and address market risk, the IA undertook constant reviews of the various requirements on insurers to keep

pace with market development. The IA had been working closely with the industry bodies to enhance transparency in the operation of the industry and to promote the professional conduct of insurance intermediaries. The industry noted that there had been significant increase in the number of claims and pay-outs in respect of employees' compensation insurance policies in recent years. The Hong Kong Federation of Insurers had set up a working group to look into the matter and would put forth recommendations to address the problem by the end of 2001.

26. Mr LEE Cheuk-yan pointed out that it was unfair to require employers to finance the Employees Compensation Assistance Fund (ECAF). The Fund was used to reimburse an employer who had taken out an insurance policy and paid compensation to an employee but was unable to obtain recovery under the insurance policy because of the insolvency of the insurer concerned. He asked whether C of I would consider undertaking a review of this policy.

27. In response, C of I advised that, similar to ECAF, an Insolvency Fund (IF), also provided compensation for a traffic accident victim whose claims for bodily injury remained unsettled owing to the insolvency of the insurer concerned. This was financed on a user-pays principle through a levy on the motor insurance premiums payable by the policy holders. The Education and Manpower Bureau was conducting a review of ECAF with reference to, among other things, the financing arrangements of IF and would make proposals in due course.

28. In reply to Mr Henry WU's enquiry about the feasibility of setting up a compensation fund for long-term insurance products, C of I said that policy holders of long-term insurance products were protected by a provision in the ICO which required liquidators to transfer the long-term business of an insolvent insurer to another insurer. Nonetheless, the IA had commenced a review to examine the need for compensation arrangements for long-term insurance business. The review would make reference to the practices of overseas jurisdictions. At the Chairman's request, C of I undertook to keep the Panel informed of the progress of the review.

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VI Any other business

29. Members were reminded that a meeting with a delegation of the Committee of Financial Affairs of the German Parliament had been scheduled for Tuesday, 10 July 2001 at 5:00 pm in Conference Room B of the Legislative Council Building.

30. The meeting ended at 12:50 pm.

Legislative Council Secretariat
4 September 2001