

27 September 2002

The Honourable Ambrose Lau Hon-chuen, GBS, JP
Chairman
Legislative Council Panel on Financial Affairs
Legislative Council
Legislative Council Building
8 Jackson Road, Central
Hong Kong

HKMA Governance

I refer to the letters from the Clerk to the Legislative Council Panel on Financial Affairs to the Secretary for Financial Services of 16 April and 25 June 2002, in which the Administration is requested to provide a paper on the governance of the HKMA. The HKMA has, at the request of the Administration, prepared the paper on this subject. While I understand that the Panel's discussion of the governance of the HKMA has been further postponed, I feel that it would be helpful to Members of the Panel in their research into this issue if the paper were to be made available to them as soon as possible. I therefore enclose a copy of the paper, and should be grateful if you would kindly forward it to Members of the Panel.

The paper provides relevant information on the background to the current institutional framework for the governance of the HKMA and the existing division of functions and responsibilities in monetary and financial affairs. This is, of necessity, a complex and somewhat legalistic subject, and the paper can only provide a broad summary of the current arrangements. In view of this, and given the importance of this subject, I strongly recommend that the Panel invite representatives from the Administration and the HKMA to be in attendance when the paper is discussed.

Yours sincerely,

Encl.

c.c. Clerk to Panel on Financial Affairs (Attn.: Ms. Anita Sit)
Financial Secretary's Office (Attn.: Mr. Howard Lee)
Financial Services and the Treasury Bureau (Attn.: Ms. Kinnie Wong)

**Information Note for
Legislative Council Panel on Financial Affairs**

Governance of the Hong Kong Monetary Authority

Introduction

1 This paper sets out the governance arrangements of the Hong Kong Monetary Authority (HKMA), the accountability and transparency arrangements, and the existing division of functions and responsibilities in monetary and financial affairs.

Legal Mandate of the HKMA

2 The HKMA was established on 1 April 1993 by merging the Office of the Exchange Fund with the Office of the Commissioner of Banking. To effect its establishment, amendments to the Exchange Fund Ordinance were passed in the Legislative Council in 1992 to empower the Financial Secretary to appoint a Monetary Authority.

3 The powers, mandate and responsibilities of the HKMA are prescribed through the Exchange Fund Ordinance and the Banking Ordinance.

4 The Exchange Fund Ordinance establishes the Exchange Fund under the control of the Financial Secretary. The Fund shall be used primarily for affecting the exchange value of the Hong Kong dollar. The Financial Secretary may also use the Fund for maintaining the stability and the integrity of the monetary and financial systems of Hong Kong, with a view to maintaining Hong Kong as an international financial centre. The Financial Secretary's control of the Exchange Fund shall be exercised in consultation with the Exchange Fund Advisory Committee (EFAC).

5 The Exchange Fund Ordinance stipulates that the Financial Secretary shall appoint a Monetary Authority to assist him in the performance of his functions under the Ordinance and to perform such functions as the Financial Secretary may direct.

6 The Monetary Authority is a person appointed under the Exchange Fund Ordinance. Other persons are appointed by the Financial Secretary to assist the Monetary Authority. The Monetary Authority exercises his powers and performs his duties under authority delegated from the Financial Secretary. The office of the Monetary Authority is known as the HKMA and the Monetary Authority as the Chief Executive of the HKMA.

7 The Banking Ordinance provides the Monetary Authority with the legal basis for the regulation and supervision of banking business and the business of taking deposits. Under the Banking Ordinance, the Monetary Authority is responsible for authorization matters under the Ordinance. These include, among others, the authorization, suspension and revocation of all three types of authorized institutions.

Governance of the HKMA

8 The HKMA operates with a high degree of day-to-day autonomy within the relevant statutory powers under the Exchange Fund Ordinance delegated to him by the Financial Secretary, and the statutory powers vested in him under the Banking Ordinance.

Governing Body

9 The Financial Secretary's control of the Exchange Fund shall be exercised in consultation with EFAC, of which he is the chairman. EFAC advises the Financial Secretary on matters relating to the governance of the HKMA, including the terms and conditions of service of staff and the annual administrative budget.

10 Members of EFAC are appointed in a personal capacity by the Financial Secretary under delegated powers from the Chief Executive. Currently, EFAC consists of 13 members (including the Chairman), with the majority (8 out of 13) coming from non-banking sectors. EFAC meets 11 times a year and on other occasions when particular advice is being sought.

11 Three sub-committees have been established under EFAC:

- (a) the Sub-Committee on Currency Board Operations, which monitors and reports on the currency board arrangements;
- (b) the Audit Sub-Committee, which gives advice and guidance on audit-related issues; and
- (c) the Remuneration and Finance Sub-Committee, which makes recommendations to EFAC on pay and conditions of service, human resources policy, and budgetary and administrative issues.

Membership lists of EFAC and its sub-committees are at **Annex 1**.

Appointments and Terms and Conditions of Service

12 The Exchange Fund Ordinance provides that the Financial Secretary shall appoint a person to be the Monetary Authority on such terms and conditions as he thinks fit, and that the Financial Secretary may appoint staff to assist the Monetary

Authority in carrying out his functions on terms and conditions different from those of the civil service.

13 The Exchange Fund Ordinance stipulates that “the emoluments payable to, and other staff costs relating to, the persons employed in connection with the purposes of the Fund” shall be charged to the Exchange Fund.

14 The terms and conditions of service of HKMA staff are determined by the Financial Secretary on the advice of EFAC. The Remuneration and Finance Sub-Committee, which comprises all non-banking members of EFAC, makes recommendations to EFAC on all matters relating to the remuneration policy and packages for HKMA staff. This includes the annual pay review, which takes place in April each year. The annual pay adjustments, to be determined by the Financial Secretary on the advice of EFAC, are made with reference to market pay trend and pay level surveys conducted by independent consultants, EFAC’s assessment of the HKMA’s performance in the preceding year and other factors that EFAC may consider relevant.

Budgetary Matters

15 The HKMA’s budget is prepared annually by the HKMA for approval by the Financial Secretary on the advice of EFAC. The budget applies to the calendar year and is normally approved in November of the preceding year. The Remuneration and Finance Sub-Committee examines the budget in detail and makes recommendations to EFAC. The Audit Sub-Committee is responsible for giving advice and guidance on audit-related issues. In addition, accounts of the Exchange Fund are subject to stringent and continuous auditing by the Director of Audit.

Functions and Responsibilities in Monetary and Financial Affairs

16 The governance arrangements of the HKMA will remain unchanged under the new accountability system. The roles and functions of the Monetary Authority are set out clearly in the Exchange Fund Ordinance and Banking Ordinance, which will not be affected by the new accountability system. The division of responsibilities in monetary and financial affairs among the Financial Secretary, the Monetary Authority and the Secretary for Financial Services is well established and has worked smoothly over the years. These arrangements, which apply equally to the new position of Secretary for Financial Services and the Treasury, are set out below.

Monetary Policy

17 The Financial Secretary shall be responsible for determining the monetary policy objective and the structure of the monetary system of Hong Kong. The Monetary Authority shall on his own be responsible for achieving the monetary policy objective, including determining the strategy, instrument and operational

means for doing so, and for maintaining the stability and integrity of the monetary system of Hong Kong.

Stability and Integrity of the Financial System

18 The Financial Secretary, assisted by the Secretary for Financial Services and the Treasury, shall be responsible for policies for the maintenance of the stability and integrity of the financial system of Hong Kong.

19 In support of these policies, the Monetary Authority shall be responsible for:

- (a) providing a measure of protection to depositors and promoting the general stability and effective working of the banking system through the regulation of banking business and the business of taking deposits, and the supervision of Authorized Institutions as provided for in the Banking Ordinance;
- (b) determining on his own prudential policies, and standards and guidelines relating to the regulation of banking business and the business of taking deposits;
- (c) considering and proposing reforms of the law relating to the regulation of banking business and the business of taking deposits;
- (d) co-operating with other relevant authorities in the supervision of business conducted by Authorized Institutions (other than banking business or the business of taking deposits);
- (e) the development of the debt market in co-operation with other relevant authorities and organisations;
- (f) matters relating to the issuance and circulation of legal tender notes and coins;
- (g) promoting the safety and efficiency of the financial infrastructure through the development of domestic wholesale and retail payment, clearing and settlement systems involving Authorized Institutions and, where appropriate, the operation of these systems; and
- (h) other operations and schemes as appropriate.

Maintenance of the Status of Hong Kong as an International Financial Centre

20 The Financial Secretary, assisted by the Secretary for Financial Services and the Treasury, shall be responsible for policies for the maintenance of the status of Hong Kong as an international financial centre.

21 In support of these policies, the Monetary Authority, when discharging his responsibilities for maintaining the stability and integrity of the monetary and financial systems of Hong Kong, shall, in co-operation with other relevant authorities and organisations, seek to promote:

- (a) the development of payment, clearing and settlement systems to facilitate the safe and efficient conduct of international and cross-border financial activities in Hong Kong;
- (b) confidence in Hong Kong's monetary and financial systems through active participation in international financial and central banking forums; and
- (c) appropriate market development initiatives that help strengthen the international competitiveness of Hong Kong's financial services.

Exchange Fund

22 The Exchange Fund shall be under the control of the Financial Secretary, as provided for in the Exchange Fund Ordinance.

23 The Monetary Authority, under the delegated authority of the Financial Secretary and within the terms of the delegation, shall be responsible to the Financial Secretary for the use of the Exchange Fund, and for the investment management of the Exchange Fund.

Accountability and Transparency of the HKMA

24 The autonomy given to the HKMA in its day-to-day operations and in its methods used to pursue policy objectives determined by the Government is compatible with and complemented by a high degree of transparency, including regular contacts with the Legislature:

- (a) there are frequent contacts between officials in the HKMA and the Legislature at Panel and Committee meetings, at which the operations and policies of the HKMA are explained and discussed. The Chief Executive of the HKMA has undertaken to appear before the Panel to brief Members three times a year. The work of the HKMA is subject to the scrutiny of Members through formal LegCo questions and in less formal contacts between Members and the HKMA, which the HKMA promotes in a programme of regular meetings and briefings; and
- (b) the audited Exchange Fund accounts are published annually in the HKMA's Annual Report, which is presented annually to the Legislative Council Financial Affairs Panel.

25 In addition to being accountable to the Legislature, the HKMA has over the past few years implemented a number of measures to increase the transparency of its work, including:

- (a) improvements to the quality and accessibility of its publications and website;
- (b) an extensive public education programme;
- (c) publication of supervisory policies and guidelines in an enhanced Supervisory Policy Manual;
- (d) progressive increases in the detail and frequency of its disclosure of information on the Exchange Fund and Currency Board Account;
- (e) participation in the International Monetary Fund's Special Data Dissemination Standard project; and
- (f) publication of the records of meetings of the EFAC Sub-Committee on Currency Board Operations.

26 The HKMA will continue to keep under review the question of whether further improvements in accountability and transparency arrangements can be made.

Hong Kong Monetary Authority
27 September 2002

EXCHANGE FUND ADVISORY COMMITTEE

Chairman : Financial Secretary (ex officio)

Members : The Monetary Authority

Mr David Eldon, JP
Chairman
The Hongkong and Shanghai Banking Corporation Limited

Mr E Mervyn Davies, JP
Group Chief Executive
Standard Chartered Bank

Mr Marvin Cheung Kin Tung, SBS, JP
Chairman and Chief Executive Officer
China & Hong Kong
KPMG

Dr The Hon. David Li Kwok Po, LLD, GBS, JP
Chairman and Chief Executive
The Bank of East Asia Ltd

Dr James Z M Kung
Chairman
Chekiang First Bank Limited

Dr Liu Jinbao
Vice Chairman & Chief Executive
Bank of China (Hong Kong) Ltd.

Professor Richard Y C Wong, SBS, JP
Dean, Faculty of Business and Economics
The University of Hong Kong

Mr Christopher Cheng Wai-chee, JP
Chairman
USI Holdings Limited

Mr Victor Lo Chung-wing, GBS, JP
Chairman and Chief Executive
Gold Peak Group

Mr Robert C Tang, SC, JP
Barrister

Mr Patrick Wang Shui Chung, JP
Chairman and Chief Executive
Johnson Electric Group

EFAC SUB-COMMITTEE ON CURRENCY BOARD OPERATIONS

Chairman : The Monetary Authority

Members : The three Deputy Chief Executives of the HKMA

Mr Marvin Cheung Kin Tung, SBS, JP
Chairman and Chief Executive Officer
China & Hong Kong
KPMG

Dr The Hon David Li Kwok Po, LLD, GBS, JP
Chairman and Chief Executive
The Bank of East Asia Ltd

Mr John Greenwood
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Department of Economics
Hong Kong Baptist University

Professor Richard Y C Wong, SBS, JP
Dean, Faculty of Business and Economics
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Dr Liu Jinbao
Chairman
The Hong Kong Association of Banks

EFAC AUDIT SUB-COMMITTEE

Chairman :

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Chairman and Chief Executive Officer
China & Hong Kong
KPMG

Members :

Mr David Eldon, JP

Chairman

The Hongkong and Shanghai Banking Corporation Limited

Dr Liu Jinbao

Vice Chairman & Chief Executive

Bank of China (Hong Kong) Ltd

Mr E Mervyn Davies, JP

Group Chief Executive

Standard Chartered Bank

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