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10 May 2006

Dr Hon Marvin CHEUNG Kin-tung, DBA Hon., SBS, JP
Chairman
Governance Sub-Committee of the Exchange Fund Advisory Committee
55th Floor, Two International Finance Centre
8 Finance Street
Central
Hong Kong

Dear Dr CHEUNG,

**Panel on Financial Affairs
Follow-up to the meeting on 4 May 2006**

On behalf of Hon Bernard CHAN, Chairman of the Panel on Financial Affairs, I write to thank you and Mr Christopher CHENG for attending the Panel meeting on 4 May 2006, and invite the Governance Sub-Committee (GSC) to provide written response on the governance issues of the Hong Kong Monetary Authority (HKMA).

You may recall that at the captioned meeting, some members of the Panel expressed concern about the governance issues of HKMA and how its transparency could be enhanced. To facilitate the Panel to consider how the matter should be taken forward, the Chairman of the Panel has accepted a member's suggestion that the GSC be invited to consider and provide written response to the research report prepared by the Research and Library Services Division of the LegCo Secretariat on "The Governance of the Hong Kong Monetary Authority and Comparable Authorities in Hong Kong and Overseas Jurisdictions" in 2003, and to members' views set out in the following paragraphs.

I now attach a copy of the research report for the GSC's consideration. Whilst appreciating that HKMA has provided its written response to the research report in April 2003 (copy also attached), the Chairman would like to invite the GSC to consider the research findings and analysis. In particular, GSC is invited to consider the following findings set out in the research report and views expressed by members:

- (a) Regulatory framework
 - (i) As indicated by the research findings, there is a growing trend for regulatory bodies to be subject to specific legislation governing

their operations, including their powers and functions (paragraph 108.4 of the research report); and

- (ii) Under the existing arrangement, the powers, functions and responsibilities of the Monetary Authority are set out in different ordinances, including the Exchange Fund Ordinance (Cap.66), Banking Ordinance (Cap. 155), Deposit Protection Scheme Ordinance (Cap. 581), Clearing and Settlement Systems Ordinance (Cap. 584), and other relevant ordinances. Some members consider this arrangement unsatisfactory and suggest that a new piece of legislation be enacted to set out clearly the powers, functions and responsibilities of HKMA, its governance structure and accountability arrangements.

(b) Funding mechanism

- (i) There are five funding mechanisms identified in the bodies covered by the research report, but HKMA is the only one which is financed by foreign exchange reserves (paragraphs 108.13 to 108.15 of the research report);
- (ii) Some members remain concerned about the existing practice under which HKMA, as an integral part of the Government, is not subject to the resource allocation mechanism applicable to other government departments. In this connection, they note that HKMA has five main functions: maintaining the stability of the Hong Kong dollar; promoting the safety of Hong Kong's banking system; managing the Exchange Fund; maintaining and developing Hong Kong's financial infrastructure; and promoting Hong Kong's status as an international financial centre. They suggest that consideration be given to revise the funding mechanism of HKMA to the effect that the expenditure involved in performing its function related to the management of the Exchange Fund be charged to the Exchange Fund, and the expenditure involved in performing its other functions be subject to the resource allocation mechanism applicable to other government departments;
- (iii) Some members are of the view that consideration should be given to enhance HKMA's transparency without affecting its operations. In this connection, further details of HKMA's annual budget should be disclosed; and
- (iv) In connection with item (iii) above, HKMA should follow the example of the Securities and Futures Commission to present its annual budget, before the commencement of each financial year, to the Panel on Financial Affairs.

(c) Remuneration of senior executives

- (i) As indicated by the research findings, the remuneration level of the Chief Executive of HKMA (CE/HKMA) is the highest among the heads of the bodies covered by the research report (page 124 of

- the research report); and
- (ii) Some members remain concerned that the remuneration level of the CE/HKMA is much higher than those of the heads of other central banking institutions, such as the Chairman of the Federal Reserve Board of the United States.

I should be grateful if you would let me have the written response of the GSC (in both Chinese and English) **by 29 May 2006**. Please forward the soft copy of the response to Ms May LEUNG at mleung@legco.gov.hk.

Please note that unless you raise objection, the response provided to the Panel will be made available to the media and public and placed in the Library of LegCo. It may also be made available on the LegCo Web Site.

Please feel free to contact me at 2869 9244 or Ms Rosalind MA at 2869 9498 if you have any enquiries.

Yours sincerely,

(Miss Salumi CHAN)
Clerk to Panel

Encl.

c.c. Hon Bernard CHAN, JP (Chairman)

Mr Christopher CHENG, GBS, JP

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enclosure