

**For information
on 9 October 2007**

**Legislative Council
Panel on Financial Affairs**

**Issues relating to the Government's increased acquisition of shares in
the Hong Kong Exchanges and Clearing Limited in September 2007**

Purpose

This paper briefs Members of the Government's increased acquisition of shares in the Hong Kong Exchanges and Clearing Limited (HKEx) in September 2007.

Objectives of the Purchase

2. The increase in the Government's shareholding in HKEx is a strategic use of the Exchange Fund to enable the Government to contribute, over the longer term, to HKEx's development, particularly in the development of strategic partnerships and links with other institutions in the region, including pursuing initiatives under the Action Agenda proposed by the Focus Group on Financial Services under the Economic Summit on "China's Eleventh Five-Year Plan and the Development of Hong Kong" (the 11-5 Action Plan).

3. The Government has purchased HKEx shares over a period since 2000. The shareholding was increased to a more significant level after HKEx became a constituent stock in the Hang Seng Index in 2006. The decision to increase the shareholding in HKEx for strategic reasons was reached after the drawing up of the 11-5 Action Plan.

4. The increase in the Government's shareholding in HKEx is not an intervention in the market, nor is it designed to undermine the independence of HKEx in any way. It is also not part of any wider

scheme to acquire shareholdings by the Government.

Authority for the Purchase

5. The decision to increase the Government's shareholding in HKEx was made by the Financial Secretary using his authority under the Exchange Fund Ordinance (EFO). Section 3(1A) of EFO provides that "the Financial Secretary may, with a view to maintaining Hong Kong as an international financial centre, use the Fund as he thinks fit to maintain the stability and the integrity of the monetary and financial systems of Hong Kong." Use of the Exchange Fund under section 3(1A) of EFO does not require consultation with the Exchange Fund Advisory Committee (EFAC). However, EFAC Members were briefed on the same day after the Exchange Fund's shareholding exceeded 5%.

Disclosure

6. In the interest of transparency and following standard market practice, the Government decided to make a disclosure of its interest in this case, although it is not bound by the disclosure provisions of the Securities and Futures Ordinance (SFO). Article 55 of the Articles of Association of HKEx, however, requires "every person shall forthwith provide written notice to the Company if he/it becomes a minority controller of the Company" ("minority controller" means any person who holds 5% or more of the voting shares under Section 61 of SFO). The Government gave a notice under Article 55 to HKEx on the day upon which the Exchange Fund's shareholding exceeded 5%.

The Exchange Fund and the Fiscal Reserves

7. Established under section 3(1) of EFO under the control of the Financial Secretary, the Exchange Fund is used primarily for such purposes as the Financial Secretary thinks fit affecting, either directly or indirectly, the exchange value of the currency of Hong Kong and for other purposes incidental thereto. In addition to using the Fund for its primary purpose, the Financial Secretary may, with a view to maintaining Hong Kong as an international financial centre, use the Fund as he thinks fit to maintain the stability and the integrity of the monetary and financial

systems of Hong Kong.

8. The fiscal reserves placed with the Exchange Fund form part of the Fund. The placement of the fiscal reserves with the Exchange Fund was done in accordance with the provisions of the Public Finance Ordinance and EFO. There is no conflict between the two.

9. The Exchange Fund is fungible and deployed as a whole for the purposes set out in EFO. However, the Financial Secretary may require the drawdown of the fiscal reserves placed with the Exchange Fund back to the general revenue at any time. The fiscal reserves placed with the Fund represent a liability in the Fund's accounts, which must be taken into account in the management of the Fund. The amount used in the purchase of HKEx shares represents a very small proportion of the assets of the Exchange Fund and does not affect the Fund's ability to meet the drawdown of the fiscal reserves back to the general revenue at the discretion of the Financial Secretary. The acquisition of HKEx shares represents a change in the asset portfolio of the Exchange Fund. It is not related to the fiscal reserves placed with the Fund, which is a liability item in the Fund's account, nor does it affect the level of the reserves placed with the Fund.

Financial Secretary's Office
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