

立法會
Legislative Council

LC Paper No. CB(1)663/07-08
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by the Administration)

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Panel on Financial Affairs

Minutes of meeting
held on Monday, 3 December 2007 at 10:00 am
in the Chamber of the Legislative Council Building

- Members present** : Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon Ronny TONG Ka-wah, SC (Deputy Chairman)
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Dr Hon David LI Kwok-po, GBM, GBS, JP
Hon James TO Kun-sun
Hon Bernard CHAN, GBS, JP
Hon SIN Chung-kai, SBS, JP
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, SBS, JP
Hon Jeffrey LAM Kin-fung, SBS, JP
Hon Andrew LEUNG Kwan-yuen, SBS, JP
Hon WONG Ting-kwong, BBS
Hon CHIM Pui-chung
Hon TAM Heung-man
- Members attending** : Hon Mrs Selina CHOW LIANG Shuk-ye, GBS, JP
Hon CHAN Yuen-han, SBS, JP
Hon LI Fung-ying, BBS, JP
Hon WONG Kwok-hing, MH
- Members absent** : Hon James TIEN Pei-chun, GBS, JP
Hon Albert HO Chun-yan

Public officers attending : Agenda Item IV
Mr John C TSANG, JP
Financial Secretary

Mr KC KWOK, BBS, JP
Government Economist

Mr Freely K CHENG
Administrative Assistant to Financial Secretary

Agenda Item V

Hong Kong Monetary Authority

Mr Raymond LI, JP
Executive Director (Banking Development)

Mr Arthur YUEN, JP
Executive Director (Banking Supervision)

Attendance by invitation : Octopus Cards Limited

Ms Prudence CHAN
Chief Executive Officer

Mr Terry HO
Finance Director

EPS Company (Hong Kong) Limited

Mr Raymond SO
General Manager

Mr Cary POON
Product Development Manager

Clerk in attendance: Miss Polly YEUNG
Chief Council Secretary (1)5

Staff in attendance : Ms Pauline NG
Assistant Secretary General 1

Mr KAU Kin-wah
Assistant Legal Adviser 6 (Agenda Item II)

Ms Rosalind MA
Senior Council Secretary (1)8

Ms Annette LAM
Senior Council Secretary (1)3

Ms Sharon CHAN
Legislative Assistant (1)8

Action

I. Confirmation of minutes of meeting and matters arising

(LC Paper No. CB(1)335/07-08 — Minutes of special meeting on 12 October 2007)

The minutes of the special meeting held on 12 October 2007 were confirmed.

II. Information papers issued since the last meeting

2. Members noted that no information papers had been issued since the last meeting.

III. Date of next meeting and items for discussion

(LC Paper No. CB(1)331/07-08 (01) — List of outstanding items for discussion

LC Paper No. CB(1)331/07-08 (02) — List of follow-up actions)

Regular meeting in January 2008

3. Members agreed that the following items be scheduled for discussion at the next regular meeting to be held on Monday, 7 January 2008 at 10:45 am:

- (a) Congestion in securities trading networks; and
- (b) Investor Participant Accounts administered by the Hong Kong Securities Clearing Company Limited.

Regular meeting in February 2008

4. The Chairman advised that in line with the normal practice, the Chief Executive of the Hong Kong Monetary Authority (CE/HKMA) would brief the Panel on the work of HKMA at the Panel meeting in February 2008. However, HKMA had notified the Secretariat that Mr Joseph YAM, CE/HKMA would not be able to attend the Panel meeting originally scheduled for 1 February 2008 as he would not be in Hong Kong on that day. The Chairman suggested and members agreed that the regular meeting for February 2008 be re-scheduled to be held on Tuesday, 29 January 2008 to facilitate Mr YAM's attendance.

5. In the light of the recent active residential property market and the increase in transactions, the Chairman proposed that HKMA/the Administration be invited to brief the Panel on the background, intended objective(s) and the implementation and application of the 70% mortgage rule adopted by the banking sector, as well as the circumstances, if any, under which the said rule could be relaxed. He suggested that the item be scheduled for discussion at the Panel meeting on 29 January 2008. Members present at the meeting raised no objection to the Chairman's proposal.

(Post-meeting note: Members were informed of the re-scheduling of meeting for February 2008 to 29 January 2008, and the advancing of the starting time of the meeting to 10:00 am for discussion of the items on the agenda vide LC Paper No. CB(1)382/07-08 on 5 December 2007.)

6. Ms Emily LAU referred to her proposal for the Panel to discuss the subject on the appointment and tenure of office of the Monetary Authority and enquired whether arrangement could be made for discussion of the subject at the meeting on 29 January 2008. The Chairman said that the Secretariat had liaised with the office of the Financial Secretary (FS) on the meeting arrangement and had been advised that as FS was under a tight schedule for the preparation of the 2008-2009 Budget, he would not be able to attend the Panel's meeting in January or February 2008. Nevertheless, the item would continue to be placed in the Panel's list of outstanding items for discussion and the Secretariat would continue to liaise with FS's office on his availability to meet with the Panel.

IV. Briefing by the Financial Secretary on Hong Kong's latest overall economic situation

(LC Paper No. CB(1)268/07-08 — Third Quarter Economic Report 2007 and the press release

LC Paper No. CB(1)331/07-08(03) — Administration's paper on recent situation and near-term outlook for the Hong Kong economy

LC Paper No. CB(1)381/07-08

— Powerpoint presentation material provided by the Administration (tabled at the meeting and soft copy issued to members on 3 December 2007))

Briefing by the Administration

7. At the invitation of the Chairman, the Government Economist (GE) briefed members on the latest developments in the Hong Kong economy, the updated economic forecasts by the Government for 2007 as a whole and the economic outlook for 2008. The salient points highlighted in the presentation were as follows:

- (a) The Hong Kong economy stayed vibrant in the third quarter of 2007, with Gross Domestic Product (GDP) leaping by 6.2% in real terms over a year earlier. This marked the 16th consecutive quarter of distinctly above-trend growth. Strength in domestic demand, vibrant financial markets and continued solid growth in trade underscored the sustained high economic growth.
- (b) Merchandise export grew notably further by 6.4% in real terms in the third quarter of 2007. Export of services accelerated further in growth, up by 12.3% in real terms, reflecting strong inbound tourism, vibrant financial market activities and continued surge in offshore trade.
- (c) Domestic demand played a key role in driving the overall economic growth. Private consumption spending grew strongly by 9.7% in real terms, supported by an improving job market and rising household income and wealth. Overall investment spending expanded further, albeit at a slower pace of 2.0% in real terms. Private sector output in building and construction showed a notable rebound in the first three quarters of 2007, yet the overall building and construction activity rose only marginally by 0.4% in the third quarter, as public sector construction activities remained on a decline.
- (d) The seasonally adjusted unemployment rate edged down to 3.9% in the three months ending October 2007, the lowest in nine and a half years. The unemployment rate for lower-skilled workers, and professional and managerial staff was down to 4.2% and 1.7% respectively. In view of the broad-based improvement in labour market, wages and earnings picked up further in June 2007 over a year earlier, representing increases in real terms after netting out inflation.
- (e) With a sustained strong economic upturn, inflation had been climbing up gradually. Headline consumer price inflation (CPI) edged up to 1.6% in the third quarter of 2007. After netting out the effects of the Rates concession and public rental waiver in February 2007, the

underlying CPI rose to 2.7% in the third quarter and 3.2% in October 2007 due mainly to the notable rise in food prices which was a worldwide phenomenon. Among the main components of Composite CPI (CCPI), the rise in food prices (excluding meals away from home) by 11.9% in October 2007 contributed most to the CCPI inflation in the third quarter of 2007. For 2007 as a whole, CCPI inflation was forecast at 2%.

- (f) Supported by further growth in jobs and labour earnings, household income continued to increase generally over the past few months. The number of households with monthly household income below \$4,000 (hereafter referred to as "low-income households") dropped by 4 300 or 2.4% to 173 600 in the third quarter of 2007 from a year earlier. There was also a decline in the number of different types of low-income households. In particular, the number of economically inactive low-income households (i.e. with all members being economically inactive) posted a more notable decline, after on a rising trend for five consecutive years.
- (g) With the strong outturn of a 6.1% GDP growth in the first three quarters of 2007 and given the prevailing strength in domestic demand, the GDP growth for 2007 as a whole was forecast at 6%. Overall, the Hong Kong economy was likely to expand further in 2008, although the growth pace should be slower than that achieved over the past four years. The economic forecast for 2008 would be announced along with the Budget Speech in February 2008. The prevailing GDP forecast by private sector analysts were averaging at around 5.1%.

Discussion

Economic development of Hong Kong

8. Mr Jeffrey LAM noted that the 2008 economic outlook for Hong Kong would hinge on a number of external factors, such as the uncertainties arising from the sub-prime problem in the United States (US). Mr LAM was concerned about the possible deterioration of the US sub-prime problem and its adverse impact on the economy of Hong Kong, as well as the measures, if any, to alleviate the impact.

9. In this regard, FS agreed that the US sub-prime problem was one of the uncertainties for the Hong Kong economy in 2008. Worsening of the US sub-prime problem would affect adversely consumer spending in the US and hence the exports of Hong Kong. The Government would monitor closely the development of the US sub-prime problem and its impact on the economy of Hong Kong. To strengthen the resilience of Hong Kong's economy in the face of global uncertainties, FS said that it was crucial for Hong Kong to increase productivity through various initiatives such as mega infrastructure projects to create employment and

education/training to enhance the skills and competitiveness of the workforce. Responding to Mr Jeffrey LAM's further enquiry on how far the increase in productivity would mitigate the impact of external factors on Hong Kong's economy, FS advised that measures to enhance productivity might not be able to offset in full the impact of the US sub-prime problem. Nevertheless, the strong growth momentum in the Mainland, the improving performance of a number of emerging Asian markets and the positive economic prospects in Europe were some of the positive developments which could support Hong Kong's external trade.

10. Ir Dr Raymond HO was concerned about the impact of global uncertainties, notably the impact of an unexpectedly steep recession in the US, on the economy of Hong Kong. In response, FS pointed out that an open and externally-oriented economy such as Hong Kong would inevitably be vulnerable to fluctuations of the global economy, which was in turn affected by the downside risk of problems faced by the US economy. To strengthen the resilience of Hong Kong's economy in the face of external uncertainties, FS stressed the importance for Hong Kong to maintain strong growth in productivity.

11. The Chairman opined that while the US sub-prime problem could have a significant impact on the global economy, Hong Kong's economic development would not be disrupted if its banking system remained sound and stable. He enquired whether the Administration had done any assessment on the sub-prime mortgage exposure of banks in Hong Kong. In reply, FS advised that the Administration had conducted stress tests on banks and other financial intermediaries on an on-going basis to assess their risk management. The findings of recent tests indicated that the US sub-prime problem would unlikely have systemic implications on the banking sector of Hong Kong.

12. Referring to paragraph 6 and Chart 3(b) of the Administration's paper, Ms Emily LAU noted that a slower increase in overall investment expenditure was recorded in the third quarter of 2007. As such, she queried why the Administration remained confident of the business outlook in the near-term. She was concerned that there would be zero or even negative growth in investment if investment expenditure continued to slow down in the coming quarters.

13. In this regard, FS and GE confirmed that the overall investment expenditure was on a rising trend notwithstanding a slower pace of growth in the third quarter of 2007 as compared with the third quarter of 2006. GE explained that Chart 3(b) presented information on the year-on-year rate of change in overall investment in real terms and the rate in the third quarter of 2007 was relatively modest when compared with the notable rebound in the third quarter of 2006. He further advised that in analyzing statistics on economic indicators, projection on the trend of development would be made by making reference to data collected over a period of time rather than only the statistics for a particular quarter. The findings of regular surveys conducted by the Administration had shown that the investing community was generally confident of the economic prospect of Hong Kong. Hence, the

Administration considered that the overall investment would remain on a rising trend.

Prospect of the financial market of Hong Kong

14. Referring to the exposure of the US's financial system to collateralized debt obligations (CDOs) through the special investment vehicle (SIV) conduit, Mr Andrew LEUNG expressed concern about the impact of such exposure on the financial system of Hong Kong. In reply, FS advised that in the open market of Hong Kong, investors would be free to choose among different types of investment funds and financial products, including CDOs through the SIV conduit, but the Administration spared no efforts in upholding the soundness and stability of the financial system of Hong Kong as a whole.

15. Given the weak US dollar and the falling trend of interest rate in US, Miss TAM Heung-man was concerned about their impact on the financial market of Hong Kong, such as the emergence of negative interest and formation of asset bubbles. She asked the Administration to assess the risks of asset bubble formation and to devise measures to cope with such risks. In response, FS advised that latest statistics in the credit lending market did not indicate that negative interest or asset bubble formation had become a serious issue of concern, with the prime rate in the range of 7% to 7.25% and CPI inflation of 2%. Despite a low real interest rate of -0.1% for savings deposits, the rate was still much higher than those of -6% to -7% in the 1990s. Responding to Miss TAM's view that the Administration should formulate suitable measures in a proactive manner before the formation of asset bubbles, FS advised that the Administration would monitor closely market developments and conduct assessments from time to time. Where circumstances so warranted, it would formulate measures to cope with risks which might arise.

16. Noting that the Chief Executive had announced in his 2007-2008 Policy Address the plan to develop an Islamic financial platform in Hong Kong, Mr SIN Chung-kai was concerned about the competitiveness of Hong Kong compared with other jurisdictions such as Malaysia and India which had already started work in this area and which had an edge in language and culture.

17. In response, FS said that Islamic finance offered huge potential for development given its rapid rate of growth in investment capital. He pointed out that appropriate modifications would have to be made in the taxation, legal and regulatory requirements for the development of an Islamic bond market in Hong Kong. Given its well-established financial system with a sound and efficient financial infrastructure in place, FS believed that Hong Kong would have a competitive edge in the provision of financial services to Islamic countries. He advised that in taking forward the initiative, the Administration would draw the attention of the financial sector to the developmental potential of Islamic finance through inviting overseas experts to share experience in Hong Kong and would promote the financial services of Hong Kong to overseas Islamic communities.

Concerns about inflation

18. Noting that inflation had been climbing up after consecutive quarters of full-fledged economic upturn, Mr Andrew LEUNG expressed concern about the adverse impact of inflation on people's livelihood and the competitiveness of Hong Kong. Mr LEUNG was particularly concerned about measures to contain inflation in the light of the weak US dollar under the currency peg and the rising prices of foodstuff and imports from the Mainland in the face of a strong Renminbi (RMB).

19. FS explained that the surge in domestic consumption was a background factor for the upward price pressure, while the rising prices of imports were the direct cause for the increase. The combined effect of a number of fiscal measures such as the waiving of Rates had served to lower the inflation for 2007 by 1%. Given the upward trend of CCPI, it might be difficult for inflation to remain at the existing level in the coming year. Nevertheless, measures to increase local productivity and efficiency could help alleviate the impact of inflation to a certain extent. As to whether the Administration had any plan to continue the waiving of Rates in the 2008-2009 financial year, FS advised that fiscal measures needed to be considered comprehensively as concessionary measures such as the Rates waiver might have expansionary effects on the economy. It was therefore necessary to strike a balance between relief measures and their consequences.

20. Noting that inflation was creeping up with an overall CPI inflation of 3.2% in October 2007 and that inflation for the component of foodstuff was at an even higher rate of 11.9% for the same period, Ms Emily LAU expressed grave concern about the resultant burden on the general public, in particular low-income households since spending on foodstuff constituted a major portion of their total family expenses. In this connection, Ms LAU also noted from the Annex to the Administration's paper that although the number of low-income households had dropped when compared with that a year earlier, it still stood at 173 600 in the third quarter of 2007. She opined that the Administration should give due consideration to providing relief measures for low-income households in the face of rising food prices.

21. Mr Ronny TONG, Miss TAM Heung-man and Ms LI Fung-ying expressed similar concern about the impact of surging prices in foodstuff on low-income households. Miss TAM opined that the Administration should utilize the abundant fiscal surplus in 2007-2008 for implementing appropriate relief measures to alleviate the hardship faced by these household. Ms LI commented that fiscal measures such as the waiving of Rates could hardly benefit people in the lower economic strata of the community as most of them did not own properties. She urged the Administration to consider other feasible measures to provide assistance to these people.

22. FS said that the Administration was keenly aware that people in the lower economic strata of the community would be most affected by inflation, in particular

the rising prices of foodstuff. In this connection, the Administration considered that the most effective way to cope with inflation was to facilitate economic growth through increasing local productivity and creating employment opportunities. The Administration was working in this direction and such initiatives included plans for mega infrastructure projects to create employment, upgrading the skills and productivity of the labour forces through education and training, and ensuring the provision of adequate land supply to meet the demand for long-term economic development. FS further advised that he had received various views and suggestions on relief measures during his consultation with Members and different organizations in the preparation of the 2008-2009 Budget. These views and suggestions would be further examined in consultation with the relevant government bureaux/departments. Relevant initiatives, if any, would be announced at the upcoming Budget Speech in February 2008. FS also drew members' attention to the figures in Chart 12 of the powerpoint presentation material and pointed out that food price hike was a world-wide phenomenon, under which the year-on-year rate of increase of world food prices in the third quarter of 2007 was 17.4%, which was much higher than the rate of 11.9% recorded by Hong Kong in October 2007.

23. GE advised that according to survey findings, the lowest two quartiles of households in terms of household income spent about 19% of their total household spending on foodstuff. As such, the 11.9% increase in food prices in October 2007 would have impact on the percentage of spending on foodstuff only. GE further pointed out that inflation in the 1980s' and 1990s' had been driven mainly by domestic factors including increases in rental cost. As to Ms Emily LAU's concern about the number of low-income households, GE explained that among the 173 600 low-income households, 114 800 were elderly households. The number of low-income elderly households and economically inactive households was on the decrease as a result of the economic recovery in the recent years. It was envisaged that the number of low-income households would drop further with continued economic growth.

24. Referring to the CPI inflation components in Chart 11 of the powerpoint presentation material, Ms Emily LAU sought further information on the reasons for the significant increase in the inflation rate of housing (4.1% in October as compared with 0.7% in the third quarter of 2007) and the decrease in the price of durable goods (-4.4% in October and -4.2% in the third quarter of 2007). She was also concerned about the forthcoming inflation rate of the price of foodstuff in November and December 2007. Noting FS's remark that the rise in food prices was a worldwide phenomenon, she enquired about the measures, if any, adopted by other jurisdictions to assist their people to cope with such price rises.

25. GE advised that the inflation rate of housing in the second and third quarters of 2007 had been lower than that in October 2007 as a result of the waiving of Rates. As to the decrease in the price of durable goods, GE pointed out that the downward trend had been in place for quite a long time. As regards the prices of foodstuff, the Administration did not have any information on the inflation for November and December at the moment but it was anticipated that the prices would increase in the

fourth quarter of 2007. GE informed members that different jurisdictions might adopt different measures to alleviate the impact of rising food prices to suit their own circumstances and there was no globally applicable measures. GE highlighted that inflation affected not only Hong Kong but also other places. For instance, the inflation in Singapore was 3.6% in October 2007, which was higher than the 3.2% in Hong Kong.

26. Noting the figures on consumer price inflation and food prices, Miss CHAN Yuen-han expressed concern about the hardship faced by low-income households, the majority of which were elderly households. She called on the Administration to respond to the strong call of the community to formulate measures to tackle the aggravating problem of working poverty and elderly in poverty. Miss CHAN suggested that to facilitate assessment of the problem of poverty, the Administration should consider providing statistics and breakdowns on households with monthly household income below 50% of the median monthly household income, in addition to information on the number of low-income households with monthly household income below \$4,000.

27. In response, FS stressed that the Administration was also concerned about the hardship faced by low-income households and elderly households in coping with rising consumer prices. The Administration would examine and formulate feasible relief measures to assist these households. On Miss CHAN Yuen-han's suggestion of providing statistics on households with monthly household income below 50% of the median monthly household income, GE advised that such numbers would show mainly the changes in the shape of the household income distribution. Having said that, GE noted Miss CHAN Yuen-han's concern and agreed to consider further the feasibility of the suggestion.

28. Referring to the overall CPI inflation for the third quarter of 2007 and October 2007 in Chart 11 and the forecast CCPI for 2007 in Chart 13 of the powerpoint presentation material, Mr Ronny TONG considered the presentation of the statistics relating to inflation confusing and sought clarification on whether the forecast inflation of 2% for 2007 could accurately reflect the extent of consumer price inflation. Mr TONG was also concerned that inflation would intensify with the increase in private consumption expenditure during the festive season in the fourth quarter of 2007.

29. GE advised that on the basis of the statistics in the first three quarters of 2007 and the latest statistics for October 2007, CPI inflation for 2007 as a whole was forecast at 2% (the forecast was 2.7% without taking into account the effect of concessionary measures). The rise in CPI inflation to 3.2% for October 2007 reflected partly the effect of the ending of the Rates concession. As to Mr TONG's concern about private consumption expenditure, GE explained further that seasonal fluctuations in the expenditure pattern would not affect significantly the year-on-year rate of change in the private consumption expenditure as the comparison was made with the same quarter in the previous year.

Employment and the labour market

30. Mr Ronny TONG enquired whether sustained economic growth in recent years had brought about significant improvement in wages. In reply, FS said that economic growth in the past few years had brought about improvement in the employment market as well as increase in wages. In this connection, GE elaborated that initially, higher-skilled labour had benefited from the economic recovery. With continued economic growth, employment opportunities in different sectors would increase and lower-skilled labour could also benefit from an increased choice of jobs, less under-employment, and the availability of more jobs. As workers had more chances to switch to jobs offering better terms, effects of the improvement in the job market would not be fully reflected by real wage increases in individual job categories. The improvement in labour income could also be reflected in the increase in consumer spending and confidence as a whole.

31. Ms LI Fung-ying noted with interest the increase in earnings in real terms for the manufacturing sector recorded in the Half-yearly Economic Report 2007. She pointed out that the reported increase contrasted with her understanding that manufacturing workers had been receiving very low wages, and doubted whether the increase was only specific to certain posts or industries in the sector. In this connection, Ms LI requested the Administration to provide detailed information and statistics on the increase in earnings for the manufacturing sector, preferably with a breakdown on the posts or industries involved.

32. In reply, GE advised that changes in nominal earnings of the manufacturing sector as a whole might be the result of the changing nature of jobs with an increasing number of office workers vis-à-vis a decreasing number of manual workers, as well as the changing population structure with most of the lower-skilled and lower-paid workers being in the middle-aged group. He agreed to provide the information required by Ms LI after the meeting, where practicable.

33. Mr WONG Kwok-hing was concerned that despite increased job opportunities and a falling unemployment rate in general, the unemployment problem in the construction industry remained acute and workers were still suffering from a double-digit unemployment rate. He pointed out that the serious unemployment problem had forced construction workers to work outside Hong Kong such as in Macao. Referring to the slow progress in taking forward public works projects and the expected underspending of the \$29 billion earmarked for public works projects in 2007-2008, Mr WONG enquired about measures to alleviate the hardship of construction workers.

34. In response, GE advised that the overall unemployment rate had dropped as a result of economic improvement which led to the creation of additional job opportunities. He pointed out that over the years, people from different industries, as

well as those at different sectors of the construction industry had been taking up jobs in places outside Hong Kong. As regard the availability of job opportunities in the local construction sector, GE noted that this had been constrained somewhat by the number of infrastructure projects as well as the relatively slow growth in building projects in both the private and public sectors. Nevertheless, the recent upturn in private sector building activities and renovation works had created additional jobs. FS supplemented that given the cyclical nature of capital works expenditure and the time required for preparation of the next batch of mega infrastructure projects, it was envisaged that capital works expenditure for 2008-2009 would still be on the low side. FS however stressed that the Administration was committed to pushing ahead mega infrastructure projects to boost capital works spending and create employment. The Administration would also strive to implement more minor works projects which would require less lead time for planning and preparation.

35. Mr Abraham SHEK was also concerned that construction workers had not been able to benefit from the economic recovery in the past few years. Pointing out that the peak of Macao's construction activities would soon be over and the job opportunities for local construction workers would thus diminish, Mr SHEK called on the Administration to streamline its internal procedures and reduce the lead time for planning public works projects. To facilitate the implementation of private sector building projects, Mr SHEK opined that the Administration should also expedite the processing of project applications from private developers.

36. In reponse, FS reiterated the Administration's commitment to pushing ahead mega infrastructure projects and other public works projects to boost economic activities and improve employment opportunities for the construction industry. To this end, the Development Bureau was actively examining measures with works departments to compress/streamline the administrative procedures with a view to shortening the planning lead time for public works projects. As regards building projects in the private sector, FS said that the Administration would continue its effort in facilitating and expediting the implementation of these projects, where possible.

37. Mr WONG Kwok-hing pointed out that the unemployment rate in remote districts and new towns such as Tung Chung and Tin Shui Wai were in fact higher than the unemployment rate for the whole territory. As such, the overall unemployment rate for the territory could not realistically reflect the unemployment situation in remote districts and new towns. Mr WONG opined that further statistics on the unemployment profile and unemployment rate of these areas should be compiled to enable a more accurate assessment of the extent of the problem. Mr SIN Chung-kai shared Mr WONG's view and suggested that the Administration should seek to create more jobs in remote districts and new towns through setting up government offices for provision of public services in these places.

38. FS noted members' views and concerns and re-affirmed the Government's commitment to providing more employment opportunities. On the problem faced by job seekers in remote districts and new towns, FS recapped that specific programmes

would be launched, such as the Hong Kong Jockey Club's plan to set up a Telebet Centre-cum-Volunteers and Training Centre in Tin Shui Wai, creating 2 500 jobs for the residents in the district. GE added that the Census and Statistics Department (CSD) had been compiling statistics on the employment and population profile by region/district on an annual basis. The compilation of such statistics at shorter intervals would have resources implications on CSD. He nevertheless pointed out that statistics with breakdowns by region/district would provide information on the special characteristics of different districts which could shed light on the different causes of unemployment and low earnings of residents in the districts concerned. Examples were the higher percentage of elderly population in Sham Shui Po and the larger number of new arrivals from the Mainland in Tin Shui Wai. GE said that the former Commission on Poverty had undertaken studies on the population and employment profiles of different districts and worked out a series of recommendations to address the specific needs of these districts. In response to Mr WONG Kwok-hing's concern about the unemployment problem in remote districts and new towns, GE undertook to liaise with CSD to see if relevant statistics on the unemployment profile and unemployment rate of remote districts and new towns could be provided.

39. Ir Dr Raymond HO also expressed concern about the unemployment problem in remote districts. Ir Dr HO opined that the development of the Lok Ma Chau Loop could provide job opportunities for residents of the New Territories and called on the Administration to expedite development in this boundary area. In reply, FS said that a high-level working group comprising representatives of the Hong Kong Special Administrative Region Government and the Shenzhen Municipal Government was established to co-ordinate and oversee cross-boundary development projects, including the Lok Ma Chau Loop. In the light of the complexity of the issues to be resolved (such as land ownership), more time would be required to sort out possible options for development of the boundary area. Ir Dr HO highlighted that in taking forward the development of the Lok Ma Chau Loop, the Administration should try to address concerns about environmental conservation and preservation at an early stage to prevent unnecessary delay to the implementation of the development project.

(Post-meeting note: The supplementary information provided by the Administration in response to members' requests at paragraphs 27, 32 and 38 above was issued vide LC Paper No. CB(1)509/07-08 on 31 December 2007.)

V. Operation of Octopus Cards and EPS payment system in Hong Kong

(LC Paper No. CB(1)331/07-08(04) — Hong Kong Monetary Authority's paper on Octopus EPS add-value transactions incident

LC Paper No. CB(1)331/07-08(05) — Octopus Cards Limited (OCL)'s

paper on Octopus EPS add-value incident update

- LC Paper No. CB(1)334/07-08 — Background Brief on the operation of Octopus Cards and EPS payment system in Hong Kong prepared by the Legislative Council Secretariat
- LC Paper No. CB(1)384/07-08 — Speaking note of Ms Prudence CHAN, Chief Executive Officer of Octopus Cards Limited)

Background information (Papers previously issued)

- (LC Paper No. CB(1)2216/06-07(02) — OCL's press release on independent review of failed Octopus EPS add-value transactions completed
- LC Paper No. CB(1)2216/06-07(03) — OCL actions in response to the report
- LC Paper No. CB(1)2285/06-07(01) — Letter dated 17 August 2007 from OCL
- LC Paper No. CB(1)2285/06-07(02) — OCL's report on the independent review under section 59(2) of the Hong Kong Banking Ordinance
- LC Paper No. CB(1)2348/06-07(01) — Letter dated 12 September 2007 from OCL
- LC Paper No. CB(1)2348/06-07(02) — OCL actions in response to the PricewaterhouseCoopers report (as at end August 2007))

Presentation by the Octopus Cards Limited and the EPS Company (Hong Kong) Limited

40. At the Chairman's invitation, Ms Prudence CHAN, Chief Executive Officer of Octopus Cards Limited updated members on the follow-up actions taken by the Octopus Cards Limited (OCL) following the PricewaterhouseCoopers (PWC) independent review report on the failed Octopus EPS add-value transactions. She highlighted the remedial actions taken and the improvement measures adopted as follows-

- (a) Customer refund arrangements

- (i) With the assistance of EPS Company (Hong Kong) Limited (EPSCO) and relevant banks, refund to customers had been effected for over 98% of the 15 270 failed Octopus EPS add-value transactions totaling around \$3.7 million and identified between January 2000 and December 2006. Refund could not be arranged for 284 failed transactions with an aggregate value of around \$66,900 due to bank account closures and insufficient information on these former bank customers. OCL would continue to explore means with the HKMA to return these unclaimed funds.
- (ii) As no record had been kept on the failed transactions dated back to the commencement of the EPS add-value service in the fourth quarter of 1998 till the end of 1999, the \$300,000 unclaimed fund involved had been held in a suspense account reserved for customer claims. OCL was committed to providing refunds to customers with valid claims. OCL would donate \$400,000 to St. James Settlement to jointly launch an "Octopus Kids Nurturing Programme" enabling some underprivileged school children to take part in various extra-curricular activities.

(b) Review of Octopus EPS add-value service

According to the PWC Report, there was no evidence to suggest that Octopus add-value channels other than EPS had been affected. Since August 2007, several meetings had been held by a task force set up to address the identified root causes of the failed Octopus EPS add-value transactions (the Task Force). OCL would not resume the Octopus EPS add-value service until all issues that caused the problem had been addressed to the satisfaction of all parties involved.

(c) Initiatives to enhance consumer protection and customer service

- (i) a Personalized Card Instant Issuance Program, which included a series of weekly road shows, had been launched since September 2007 to encourage the use of and application for Personalized Cards (P-cards). The \$20 application fee would be waived for P-card applications from 1 August 2007 to 31 July 2008.
- (ii) OCL had promoted its automatic add-value service whereby money was added to the Octopus cards before it was deducted from the credit card accounts. This service also enabled OCL to proactively contact customers should the need arise.

- (iii) A total of 377 transaction-enquiry machines were available at MTR stations to enable customers to check the 10 most recent Octopus card transactions. To facilitate making transaction enquiry from home or office, a pilot program would be launched in early 2008 to provide a broadband phone-based enquiry service via a personal reader. A technical platform was being developed to provide a personal computer-based enquiry service via a personal reader scheduled to be launched in mid 2008.
- (iv) Effective from 1 June 2007, all cardholders could obtain printout of the 10 most recent transactions at MTR customer service counters at a fee of \$3 charged by MTR. Cost of obtaining printouts for the last 40 transactions was reduced from \$200 to \$100.
- (v) Since April 2007, the OCL hotline service hours had been extended to operate from 9 am to 9 pm, six days a week.
- (vi) A customer-engagement program "Friends of Octopus" was launched in August 2007 to strengthen communication with customers. Over 33 000 members had been recruited and about 100 suggestions on OCL's products and services had been received.

41. Mr Raymond SO, General Manager of EPSCO said that EPSCO had actively participated in the Task Force to assist in identifying the most satisfactory solutions to address the causes of the failed Octopus EPS add-value transactions.

Briefing by the Hong Kong Monetary Authority

42. The Executive Director (Banking Development) of the Hong Kong Monetary Authority (ED(BD)/HKMA) briefed members on the regulatory framework and development of the multi-purpose stored value card (MPC) market in Hong Kong. Under the current regulatory regime enshrined in the Banking Ordinance (BO)(Cap.155), all licensed bank in Hong Kong could issue MPCs and a non-banking institution could become a special-purpose deposit-taking company for issuing MPC. He highlighted that although a number of MPC schemes such as Mondex and VisaCash introduced in Hong Kong some years ago had gradually faded out, leaving OCL the only existing MPC issuer in Hong Kong, the regulatory regime provided a level playing field for existing and potential market players. In addition to its obligations under BO, OCL was also required to comply with the Code of Practice for Multi-Purpose Stored Value Card Operation (MCP Code) which it voluntarily adopted in 2005. The MCP Code specifically required that OCL should not adopt any measures which unfairly limited competition in the MPC market and that OCL should share its technical platform with any other parties interested in card

issuing after taking into account security requirements and reasonable commercial considerations. To improve competition in of the MPC market, HKMA had played a more active role as a facilitator and had discussed with various parties, including OCL, other card scheme operators and card issuers, to explore possible ways of introducing competition to the MPC market. To offer more choices to cardholders without affecting the backbone system and smooth functioning of the current operation of the Octopus Card, opening up the card-issuing business of Octopus was an option considered worth pursuing.

Discussion

Review of the Octopus EPS add-value service

43. Noting that OCL had made refunds to customers affected by failed Octopus EPS add-value transactions identified between January 2000 and December 2006, Miss TAM Heung-man was concerned whether refunds had been or could be made to all affected customers since the commencement of the Octopus EPS add-value services; and if not, actions to be taken by OCL to follow up the cases.

44. Ms Prudence CHAN of OCL advised that the Octopus EPS add-value service was launched in the fourth quarter of 1998. However, records on failed transactions were only available for the past seven years (i.e. from January 2000 until February 2007 when the service was stopped) for which review and refunds could be arranged. For the period between the commencement of the service until the end of 1999, unclaimed funds amounting to \$300,000 had been held in a suspense account from which refunds would be made to customers with valid claims. OCL would also donate \$400,000 to St. James Settlement for launching a joint programme to provide financial assistance for underprivileged school children to participate in extra-curricular activities.

45. While appreciating that the operation of retail payment instruments might not be flawless, Mr WONG Ting-kwong was dissatisfied with the delay of OCL in taking necessary remedial actions to arrange refunds to customers affected by failed EPS add-value transactions. Mr WONG noted with concern that OCL had kept the unclaimed funds in a specific account for years since the introduction of the EPS add-value service in 1998 and had only arranged refunds to customers in response to complaints about the failed EPS add-value transactions in February 2007. He opined that if OCL had reviewed its operation and arranged refunds to affected customers on its own accord years ago, it would have been able to review the transaction records from 1998 to end 1999 as well. He urged OCL to improve its operational transparency in this regard. Ms Emily LAU shared Mr WONG's view on the need for OCL to take prompt remedial actions on faulty transactions and to improve transparency in its operation.

46. In reply, Ms Prudence CHAN appreciated members' concern about the importance of transparency in the operation of the Octopus card system. To enhance transparency and communication with customers, Ms CHAN advised that a number of

initiatives had been launched by OCL, notably the "Friends of Octopus" program designed to strengthen OCL's two-way communication with customers and to gather input from customers for the development of OCL's product and services. Responding to members' enquiry about OCL's plan, if any, of resuming the Octopus EPS add-value service, Ms CHAN stressed that OCL would accord priority to the protection of customers' interest over the convenience of services and hence would only resume the EPS add-value service when all issues that caused the problem had been fully resolved. She assured members that the Task Force had been working in full gear with a view to arriving at a decision on the resumption of EPS add-value service or otherwise shortly. Ms Emily LAU requested OCL to keep members posted of its decision on whether to resume the Octopus EPS add-value service in due course.

(Post-meeting note: OCL's written response to Ms LAU's request above was circulated to members vide LC Paper No. CB(1)496/07-08 on 24 December 2007.)

Regulation of the multi-purpose stored value card market

47. While supporting HKMA's work in promoting competition in the MPC market, Miss TAM Heung-man opined that consumers' interest could only be safeguarded with proper regulatory oversight over the MPC market. Miss TAM was concerned that HKMA had not been aware of the failed Octopus EPS add-value transactions in the past years until complaints were lodged by customers in early 2007. She therefore called on HKMA to review whether improvements should be made to the existing regulatory regime to prevent failures in the operation of MPC systems.

48. In reply, the Executive Director (Banking Supervision)/HKMA (ED(BS)/HKMA) advised that the failed Octopus EPS add-value transaction incident involved issues relating to the operational risk management of the service providers concerned, of which a high standard had been set under the existing regulatory regime. He pointed out that the regulator could not take over the important function of risk management and internal control that should be performed by the management of authorized institutions in their day-to-day operation. In the present incident, it was important to note that HKMA had taken prompt action in the wake of the failed Octopus EPS add-value transactions, including the appointment of Prof CHAN Chi-fai as an Advisor to OCL and the requirement for OCL to commission an independent auditor to review the root causes of the incident. HKMA had examined the findings of the independent auditor and considered that the review had been conducted in a comprehensive and practical manner. ED(BS)/HKMA nevertheless agreed that there was always room for improvement in any regulatory framework and the experience of this incident would provide useful reference to HKMA in setting supervisory focuses for institutions authorized to issue MPCs.

49. Mr TAM Heung-man remained concerned whether the operation of OCL's services was subject to adequate regulatory oversight, such as the internal control of

OCL's operation through regular reports on operational risk assessments. In response, ED(BS)/HKMA reiterated that a high standard on operational risk management was already required under the existing regulatory regime and ongoing supervisory efforts in this regard were robust. HKMA had requested OCL to appoint an independent auditor to review the failed add-value transaction incident as well as broader issues including the management of operational risks of OCL. Recommendations to improve the management of operational risks had been set out in detail in the auditor's report. HKMA would monitor progress of implementation of these recommendations and where appropriate, incorporate the relevant recommendations in the ongoing supervisory process.

Promoting competition in the multi-purpose stored value card market

50. Noting HKMA's view that opening up the card-issuing business of Octopus was an option considered worth pursuing, Ms Emily LAU enquired about HKMA's role and work in promoting competition in the MPC market. In reply, ED(BD)/HKMA advised that HKMA had assumed the role of a facilitator in its discussion with parties concerned to explore possible ways of promoting competition in the MPC market. As the development of the technical platform for MPCs involved heavy investment, it might not be financially viable for new entrants to develop their own platform. Promotion of competition in the market through opening up the card-issuing business with shared use of OCL's technical platform, subject to security requirements and reasonable commercial considerations, was therefore considered an option worth pursuing. Enhanced competition in the MPC market would enable consumers to benefit from a wider choice of MPC services and probably at lower costs. In promoting competition, ED(BD)/HKMA nevertheless reiterated that HKMA would facilitate rather than adopt a "hands-on" approach in market development.

51. Ms Emily LAU appreciated that increased market competition would ultimately benefit consumers, and called on HKMA to assume a more proactive role in promoting market competition instead of continuing its reactive role as a facilitator. Noting HKMA's comment that the introduction of contactless credit cards would likely compete intensely with Octopus Cards, Ms LAU enquired when and how consumers could benefit from this new product. Mr SIN Chung-kai supported the development of a diversity of electronic payment instruments to promote competition in the MPC market and provide choices to customers. He also highlighted the need to ensure security if OCL's technical platform was to be shared with other parties interested in the card-issuing business.

52. In response, ED(BD)/HKMA said that HKMA was working in a proactive manner in pursuing measures to improve the competition environment of the MPC market. He clarified that contactless credit cards operated on a different system and would not share the technical platform of Octopus cards. While these credit cards would offer a comparable level of convenience and speed of transactions as Octopus cards, they could only be used at merchant outlets where the requisite technical devices had been installed. On concerns about security, ED(BD)/HKMA assured

HKMA
A members that security and efficiency of MPC systems were matters of primary concern to HKMA in facilitating market competition. As to Ms Emily LAU's concern about the progress and timeframe for the development of new market products, ED(BD)HKMA advised that HKMA would monitor market developments closely with a view to reverting to the Panel on new developments at an appropriate time.

Strengthening consumer protection

53. To encourage and promote the use of P-cards by customers, Miss TAM Heung-man called on OCL to consider members' request at the Panel meeting in March 2007 to issue P-cards with no additional charge, instead of only waiving the \$20 handling fee on P-card applications from 1 August 2007 to 31 July 2008. In reply, CEO/OCL advised that OCL would consider, subject to customers' response to the promotion program, whether the application fee should continue to be waived and duration of for the waiver. ED(BD)/HKMA added that promoting competition in the MPC market with new entrants to compete with OCL in the provision of MPC services might address the concern about charges for P-cards in the long run.

54. To strengthen protection of Octopus cardholders, Mr WONG Ting-kwong requested OCL to consider a number of suggestions from the Democratic Alliance for Betterment and Progress of Hong Kong, including:

- (a) stepping up the promotion of P-cards with a view to encouraging wider use by customers;
- (b) abolishing the \$50 deposit for Octopus cards;
- (c) facilitating Octopus cardholders' checking of balance through the Internet;
- (d) providing printed receipts through automatic add-value machines at MTR stations;
- (e) reducing the lead time required for disabling Octopus cards upon report of card losses; and
- (f) providing a dedicated hotline for reporting card losses.

55. Mr SIN Chung-kai was concerned whether P-cards had been widely used by Octopus cardholders. To provide better customer services and safeguard the interests of customers, Mr SIN opined that OCL should consider improving its system to provide on-line services.

56. Ms Prudence CHAN thanked members' valuable views and said that OCL had aimed to provide a choice to customers in promoting the use of P-cards. Under the Personalized Card Instant Issuance Program, customers might choose to apply

for P-cards conveniently during the road shows organized by OCL. Responding to Mr SIN Chung-kai's enquiry about the percentage of P-cards issued, Ms CHAN advised that among the 15 million or so Octopus cards issued, about 10% were P-cards. As to the \$50 card deposit, Ms CHAN pointed out that taking into account the card cost of \$30 and to cater for debiting the card for the fare for the last journey, there was no room for reduction or waiving of the deposit.

57. On measures to facilitate cardholders' checking of their transactions and card balance, Ms Prudence CHAN assured members that OCL was committed to providing more convenient channels, where technically feasible. She nevertheless pointed out that the Octopus card was designed as a contactless card which was not configured for on-line checking. As the Octopus card was initially designed for use on public transport, priority had been given to speed and safety of transactions in the system design rather than retrieval of transaction details. Moreover, the large daily transaction volume of about 11 million would require considerable system capacity to cater for customers' on-line enquiry needs. The time gap between different merchants in feeding the transaction data to OCL for updating was another technical difficulty to be overcome in the provision of real time transaction information to cardholders. Ms CHAN advised that in the face of technical constraints of the existing system design, OCL was working in collaboration with relevant service providers on the development of additional channels for customers to check their 10 most-recent transactions using card-reading devices installed to their computers with Internet service or broadband telephones.

OCL

58. The Chairman noted the new initiatives introduced by OCL to strengthen customer service, in particular the reduction of cost for obtaining printouts for the last 40 transactions from \$200 to \$100. Pointing out that as there was only a small number of customers requiring such printouts, the Chairman called on OCL to reduce further the cost for obtaining the printouts.

VI. Any other business

59. There being no other business, the meeting ended at 12:40 pm.

Council Business Division 1
Legislative Council Secretariat
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