

立法會
Legislative Council

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**Report of the Panel on Financial Affairs
for submission to the Legislative Council**

Purpose

This report gives an account of the work of the Panel on Financial Affairs from October 2007 to end June 2008. It will be tabled at the meeting of the Legislative Council (LegCo) on 2 July 2008 in accordance with Rule 77(14) of the Rules of Procedure of LegCo.

The Panel

2. The Panel was formed by a resolution passed by the Council on 8 July 1998 and as amended on 20 December 2000, 9 October 2002 and 11 July 2007 for the purpose of monitoring and examining government policies and issues of public concern relating to financial and finance matters. The terms of reference of the Panel are in **Appendix I**.

3. For the 2007-08 session, the Panel comprises 16 members, with Hon CHAN Kam-lam and Hon Ronny TONG elected as Chairman and Deputy Chairman respectively. The membership list of the Panel is in **Appendix II**.

Major work

4. During the 2007-08 session, the Panel continued to provide a forum for LegCo Members to exchange views with the Financial Secretary (FS) on matters relating to Hong Kong's macro-economic situation. The Panel also received briefings by the Chief Executive of the Hong Kong Monetary Authority (CE/HKMA) on the work of HKMA. Issues related to banking services, the regulatory framework for securities and futures and the implementation of the Mandatory Provident Fund (MPF) System received ongoing attention.

Hong Kong's macro economy

5. The Panel was pleased to note that Hong Kong's economy continued to expand strongly in the first quarter of 2008 despite growing adversities in the external environment. With real Gross Domestic Product (GDP) growing by 7.1%, the economy had shown above-trend growth for 18 quarters. Export of goods and services and domestic demand remained strong. Nevertheless, the Panel was wary of uncertainties prevailing in global markets in the second half of 2008, in particular signs of recession in the United States (US) and other developed economies. The building up of inflationary pressure around the world was of grave concern to the Panel.

Inflationary outlook

6. The Panel followed closely the upward inflationary trend in Hong Kong in the past year or so, after years of solid growth as the economy rose from the trough in 2003. Members sought information on the background and factors leading to the current level of inflation and the forecast developments. They were keen to ensure that effective measures would be formulated and put in place to alleviate the impact of inflation on various sectors of the community, especially the disadvantaged and low-income groups.

7. Some members were concerned that under the Linked Exchange Rate (LER) System, Hong Kong was unable to pursue a discretionary monetary policy to reduce inflationary pressure. The Administration nevertheless advised that the weakening of the Hong Kong dollar in tandem with the US dollar was not a major factor for the recent rise in inflation. The Panel was informed that a 10% depreciation of the US dollar against all currencies except the Hong Kong dollar would lead domestic prices to increase by 0.8% only in the short run and 1.6% in the medium run. The pass-through of exchange rate changes to consumer prices was therefore relatively low.

8. Regarding members' concern about the adverse impact of inflation on the economy, the Administration advised that a low level of inflation was not necessarily bad because this would allow prices to change to balance the demand and supply conditions more effectively. Hong Kong's economic competitiveness would unlikely be undermined because the current rate of inflation in Hong Kong was comparable to those prevailing in its major trading partners.

Coping with inflationary pressure

9. Noting that inflation in Hong Kong was driven by developments in the external environment and the state of the domestic economy, the Panel was deeply concerned about the global rise in food and oil prices. As the inflation rate of foodstuffs in the first quarter of 2008 stood at 17.4% and food expenses usually accounted for a large share of the expenditure of lower-income households, members were gravely concerned about the hardship faced by the grassroot

population. While the Administration cautioned against intervention in the free market price setting process, it would continue to secure a stable supply of food for Hong Kong and to ensure effective market competition at the import and retail levels so that consumers could benefit from more choices and competitive prices.

10. Responding to the Panel's concern about the Government's commitment to assist the needy to cope with inflation, the Administration highlighted the 20 or more measures announced in the 2008-09 Budget. Some members also called on the Administration to provide more assistance to small and medium enterprises in the face of a possible recession in major trading partners, increased operating costs and more stringent regulatory requirements in the Mainland. To relieve the difficulties faced by the transportation industry and motorists, the Administration was asked to critically review various fuel duties (such as those on unleaded petrol, low-sulphur diesel and Euro V diesel) with a view to further lowering or waiving them. There was also the suggestion that to promote economic activities, the procedures for modification of land leases should be expedited. Some members held the view that in addition to one-off measures, the Administration should formulate a clear policy and introduce longer-term measures that could effectively address the needs of the grassroot population and narrow the wealth gap. In this regard, the Administration considered that the sustained growth in labour productivity would help cushion the upward pressure on prices.

Employment

11. Noting that people's living standard would not decline if the increase in their income was on par or faster than inflation, some members were gravely concerned that despite the record-low unemployment rate of 3.4% in the first quarter of 2008 and nominal pay rises across-the-board, the increase in the earnings of low-skilled workers remained moderate and lagged behind inflation. They cautioned that the upsurge in earnings of higher skilled workers might widen the disparity between the rich and the poor.

12. The Panel noted the Administration's response that in addition to the relief measures announced in the 2008-09 Budget, it would continue to promote economic development and generate more employment opportunities for the lower skilled. The Administration stated that it would enhance the productivity of the labour force through investment in education, training and retraining, as well as enlarge the productive capacity of the economy through investment in infrastructure projects.

Monetary Affairs

The Exchange Fund (EF)

13. The Panel continued to monitor the investment and management of EF and noted that as at end March 2008, the accumulated surplus of EF amounted to HK\$583.6 billion while the Fiscal Reserves placed with EF were HK\$503.2 billion.

Members also noted the revised income-sharing arrangement between the Fiscal Reserves and EF effective since 1 April 2007 under which the return on the Fiscal Reserves would be the average rate of return of the EF's investment portfolio over the past six years, or the average yield of three-year EF Notes of the preceding year, whichever is higher. For the fiscal year 2008-09, the fixed rate of fee payment to the Treasury was 9.4%.

14. As advised by HKMA, 2008 would be a difficult year for investment. Members noted that in the first quarter of 2008, EF's investment in Hong Kong and overseas equities incurred a loss of some HK\$52 billion. Offset by gains in foreign exchanges and the returns from bonds, an investment loss of HK\$14.6 billion was recorded. In examining market volatilities and the current investment strategy of EF, the Panel was informed by HKMA that the loss amounted to less than 1% of the total assets of EF and the investment income in April 2008 could cover the loss incurred in the first quarter of 2008.

Currency stability

15. Members noted that outstanding renminbi deposits in Hong Kong increased by 7 billion yuan and 7.4 billion yuan in January and February 2008 respectively, growing faster than previously. They sought information on the impact of the growth in renminbi deposits on the Hong Kong dollar. According to HKMA, the impact on the Hong Kong dollar and the Mainland's money supply was minimal, as renminbi deposits currently accounted for only 0.8% of total deposits in Hong Kong, while remitted deposits amounted to only 0.13% of the increase in renminbi savings deposits in the Mainland.

16. The Panel noted that although solid economic fundamentals continued to underpin Hong Kong's currency and monetary stability, there were a number of risks, notably lingering turmoil in the financial market, the possibility of a recession in US, increasing inflationary pressures and vulnerability of the Mainland economy. The Panel would continue to monitor further developments.

17. Some members reiterated their view that Hong Kong might draw reference from neighbouring countries in adopting a more flexible exchange rate policy. In response, the Administration reaffirmed its policy stance that the existing LER System provided Hong Kong with a firm monetary anchor and had served Hong Kong well since 1983. The Administration had no plan to change or abandon it.

Banking stability

18. The Panel noted from HKMA that the fallout of the US sub-prime crisis had not caused any systemic problem in the local banking sector although individual banks might suffer from their investment in asset-backed securities. Banks remained well capitalized and highly liquid, with strong profit growth recorded in 2007. Nevertheless, in the light of global uncertainties faced by banks,

HKMA assured members that it would continue to monitor banks' asset quality and review their risk management systems. For instance, the Panel noted that HKMA issued a circular in March 2008 asking authorized institutions to cease the practice of providing mortgage loans with a principal repayment holiday of two to three years.

19. The Panel also examined the implementation of the 70% loan-to-value ratio for residential mortgage loans voluntarily adopted by the banking industry since November 1991 as a risk management measure. Some members reiterated their concern about media reports that a former top civil servant had obtained a mortgage loan of 100% of the value of the property and sought explanation from the Administration. The Panel also passed a motion urging the Government to look into and account for the specific case.

20. The Panel attached great importance to a healthy and properly regulated banking sector in Hong Kong. Noting that HKMA had appointed a consultant in December 2007 to conduct a review of HKMA's work on banking stability, the Panel looked forward to exchanging views with HKMA and the consultant after the latter had formulated his recommendations.

The appointment and tenure of the Monetary Authority (MA)

21. Arising from press reports about the correspondences between the Governance Sub-Committee of the Exchange Fund Advisory Committee and FS on the tenure of the office of the incumbent MA, the Panel sought information and gave views on the existing arrangement for the appointment of MA as provided under section 5A of the Exchange Fund Ordinance (Cap. 66) (EFO). Noting that EFO empowered FS to appoint MA and set his terms and conditions of employment, some members were concerned about the lack of transparency and whether the appointment of MA would be subject to political considerations. To properly safeguard the independence of MA in discharging his functions and to provide for greater accountability, some members considered that there should be a clearly promulgated policy on the appointment of MA, and urged for the introduction of governing legislation for HKMA, similar to that applicable to other regulators such as the Securities and Futures Commission (SFC) and the Mandatory Provident Fund Schemes Authority (MPFA).

22. When making reference to overseas central banks, one of the main queries raised by members was the remarkably higher remuneration enjoyed by the incumbent MA, given Hong Kong's relatively small economy and the absence of a discretionary monetary policy. As explained by the Administration, the levels of remuneration of MA and other heads of central banks were not strictly comparable as the scope of responsibilities of HKMA, which straddled monetary, banking and financial infrastructure, was quite different from the purview of individual overseas central banks.

Securities and futures

Congestion in securities trading networks

23. Several incidents of trading network congestion experienced by banks and broker firms at times of heavy trading and the delay in executing buying and selling orders during the debut trading of a newly listed stock in early November 2007 sparked off concerns about the reliability and stability of the securities trading infrastructure in Hong Kong. The Panel sought explanation from the Administration, the Hong Kong Exchanges and Clearing Limited (HKEx) and SFC on the reasons and seriousness of the congestion problem and the remedial action taken to prevent recurrence. As advised by HKEx, it had suitably modified the arrangements for processing the transactions of popular newly listed stocks and such arrangements were well-tested in the debut trading of another stock.

24. Members were also concerned about the capacity and reliability of on-line trading systems operated by authorized institutions (e.g. banks) and financial intermediaries (e.g. broker firms), which were also crucial for uninterrupted transactions. Noting that HKMA and SFC had different requirements on system capacity, the Panel asked the Administration/SFC/HKEx to consider formulating objective service standards for compliance by financial intermediaries.

The Securities and Futures Commission

25. The Panel was briefed on SFC's revised estimates for 2007-08 and its Budget for 2008-09. Noting that SFC's reserve amounted to some \$3.5 billion as at end December 2007, which was 5.9 times its approved operating expenditure, some members urged SFC to actively consider reducing the levies on securities and futures trading and waiving or reducing the licence fees on brokers/intermediaries. The Administration/SFC pointed out that market volatilities and the projected increase in SFC's estimated operating expenditure for 2008-09 called for a more prudent approach. Nevertheless, they undertook to review the rates of levy regularly and would make the best use of the reserve to fund new initiatives.

26. Members sought explanation on SFC's significant increase in Personnel Expenses in the 2008-09 Budget, which was 21% higher than that forecast in 2007-08. While assuring members that it would exercise vigilant control over resources, SFC highlighted that the growing complexity in market activities, the launch of new investment products and regulatory policies and issues related to the China market would require additional manpower for SFC to perform its regulatory role effectively.

Investor protection

27. Adequate protection for investors in an increasingly complex market environment remained a major concern for the Panel. Members were aware of complaints about financial advisors from intermediaries or banks providing

inadequate or misleading information to their clients with regard to various derivatives and financial products. They were concerned about the possible conflict of interests where the financial institution was the issuer of the product in question. They also highlighted the need to review the relevant guidelines issued to financial institutions, in particular those relating to risk disclosure. In this regard, the Panel was informed that SFC would regularly monitor the conduct of practitioners and where necessary, would issue additional guidelines and rules on sales practices and disclosure requirements. Ongoing and new investor education programmes would also be launched. The Panel will meet with the Administration, SFC and HKMA in early July 2008 to discuss the regulation of increasingly sophisticated investment products and the sales practice of financial institutions in promoting such products. The protection, if any, accorded to the so-called "professional investors" will also be examined.

28. Members also considered the effectiveness of the Stock Segregated Accounts (SSAs) and the Investor Participant Accounts (IPAs) introduced in 1994 and 1998, and expressed concern about their low take-up rate. For more effective safeguards against the risks of misappropriation by brokers, the Administration was asked to consider, in collaboration with SFC and HKEx, the feasibility of incorporating the use of IPAs under the existing stock trading regime, instead of just an optional service for investors.

Closing Auction Session

29. The Panel noted with concern the price volatilities and high turnover of certain stocks recorded during the Closing Auction Session on 30 May 2008. In reviewing the matter with HKEx, SFC and the Administration, the Panel sought explanation on the background leading to the implementation of the Closing Auction Session, the trading activities on that day and remedial action by the regulators to prevent recurrence and improve the system.

30. One of members' major concerns was the possibility of market manipulation by large brokers on 30 May 2008. According to HKEx, the market volatilities were mainly caused by passive fund managers who needed to adjust their portfolios to reflect the rebalancing of the MSCI indices. On regulatory action, members noted that HKEx had conducted a comprehensive review and analysis on trading activities during the Closing Auction Session on 30 May 2008. The HKEx's findings were being considered by SFC, and where evidence so warranted, appropriate regulatory action would be taken. Meanwhile, the Administration also assured members that it would continue to monitor market developments under the existing regulatory framework underpinned by SFC and HKEx.

Mandatory Provident Fund system

Increasing employees' control over MPF investment

31. Responding to concerns about the need for greater employees' participation in the choice of MPF schemes and fund investment, the Administration and MPFA consulted the Panel on a proposal to allow an employee to transfer the accrued benefits derived from the employee's mandatory contributions from the employer-chosen MPF scheme to an employee's personal account in a scheme of his own choice at least once a year.

32. In examining the pros and cons of the proposal, some members considered that the proposal fell far short of giving employees full control of their MPF investment as they could neither transfer the accrued benefits derived from the employer's mandatory contributions to a scheme of their choice, nor choose the MPF scheme for making mandatory contributions. They called on the Administration to introduce more substantial improvement instead of proposing piecemeal changes for the sake of expediency.

33. Some members however supported the proposal as a pragmatic approach to address the needs of different stakeholders, although they were concerned about the possible increase in administrative costs on employers of small and medium enterprises. They considered that giving employees full control of their MPF investment might be unfair to employers, in particular when the employee chose to put all contributions into high-risk investment and incurred losses, resulting in insufficient accrued benefits (derived from the employer's contributions) for offsetting severance/long service payment. The Panel considered it necessary to gauge the views of different stakeholders on the proposal and met with deputations in late June 2008.

Proposal on government injection into accounts of members of MPF schemes and Occupational Retirement Schemes (ORSO schemes)

34. In principle, the Panel welcomed the announcement by FS in the 2008-09 Budget to make a one-off injection of \$6,000 into the accounts of eligible members of MPF schemes and MPF-exempted ORSO schemes. It also gave views on the legislative proposal to implement the injection. The Panel noted that the Administration had decided to expand the scope of the proposal to cover employees and self-employed persons who had recently terminated their employment and all those who had opted to join an ORSO defined benefit scheme, if the monthly income of their last employment between 1 March 2007 and 29 February 2008 did not exceed \$10,000. Some members asked whether the \$6,000 could be withdrawn prior to the age of 65 so that low-income groups could make use of it to cope with the rising cost of living. The Administration reiterated that the objective of the proposal was for retirement protection of the workforce and not a financial relief.

Banking services

35. In view of widespread public concern over the closure of quite a number of bank branches in recent years, the Panel continued to follow up the matter with the Hong Kong Association of Banks (HKAB), the Consumer Council, HKMA and the Administration. One of members' main concerns was the availability of basic banking services, and whether non-branch channels such as Automated Teller Machines (ATMs) and e-banking could cater for the needs of elderly and other underprivileged customers. The Panel discussed the effectiveness of various improvement initiatives taken by the banking industry, such as additional retail outlets providing cash withdrawal service, setting up more bank branches in public housing estates and the launch of a community-wide education campaign to teach the elderly how to use ATMs.

36. In this connection, the Panel passed a motion requesting the Government to establish a working group comprising representatives from concern groups, HKAB and the Consumer Council to recommend initiatives to meet the needs of the elderly, the underprivileged, the disabled and low-income groups for banking services; and to submit a report to the Panel in six months. In its response, the Administration confirmed that it was considering an appropriate mechanism through which the views and suggestions from different user groups could be effectively gauged. The Administration undertook to involve and consult the relevant parties and organizations in the process and to provide a progress report at the appropriate juncture.

Review of the Personalized Vehicle Registration Marks (PVRM) Scheme

37. The Panel was briefed on the outcome of the review of the PVRM Scheme after its first year of implementation, and noted that during the period September 2006 to September 2007, nine auctions had been held with 2 058 PVRMs sold. The total proceeds were about \$58.2 million, which fell short of the original estimate of \$70 million. The Administration advised that the use of PVRMs had not given rise to enforcement problems.

38. Some members considered the recurrent cost of running the PVRM Scheme at some \$7 million on the high side and asked whether there was room for cost reduction. The Administration's view was that the current resources requirement was appropriate given that the selection, checking and vetting procedures for PVRM applications were more complicated than those for traditional VRMs and had to be conducted in accordance with the relevant legislation. Regarding members' query about the discrepancy in estimated and actual auction proceeds, the Administration explained that it could only base its initial estimate on the auction of traditional VRMs in the absence of any precedent case for reference. The Administration would provide a report to the Panel in a year's time after further review of the PVRM Scheme.

39. From October 2007 to end June 2008, the Panel held a total of 13 meetings.

Council Business Division 1
Legislative Council Secretariat
24 June 2008

Legislative Council

Panel on Financial Affairs

Terms of Reference

1. To monitor and examine Government policies and issues of public concern relating to financial and finance matters.
2. To provide a forum for the exchange and dissemination of views on the above policy matters.
3. To receive briefings and to formulate views on any major legislative or financial proposals in respect of the above policy areas prior to their formal introduction to the Council or Finance Committee.
4. To monitor and examine, to the extent it considers necessary, the above policy matters referred to it by a member of the Panel or by the House Committee.
5. To make reports to the Council or to the House Committee as required by the Rules of Procedure.

**Legislative Council
Panel on Financial Affairs**

Membership list for 2007 - 2008 session

Chairman	Hon CHAN Kam-lam, SBS, JP
Deputy Chairman	Hon Ronny TONG Ka-wah, SC
Members	Hon James TIEN Pei-chun, GBS, JP Hon Albert HO Chun-yan 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 (Total : 16 members)
Clerk	Miss Polly YEUNG
Legal Adviser	Mr KAU Kin-wah
Date	11 October 2007