

LEGISLATIVE COUNCIL BRIEF

**ALIGNMENT OF INVESTMENT POLICIES OF
LAND FUND AND EXCHANGE FUND**

INTRODUCTION

1. This note informs Members of the Financial Secretary's decision to merge the assets of the Land Fund into the Exchange Fund in return for the Land Fund receiving consideration equivalent to the market value of its assets as at 31 October 1998.

BACKGROUND

2. The Land Fund was established on 1 July 1997 by a Resolution passed by the Provisional Legislative Council pursuant to Section 29 of the Public Finance Ordinance. Under this Resolution, the Financial Secretary may "in his discretion, authorize and direct the investment of any assets of the Land Fund which are not immediately required to meet expenses in respect of the Land Fund at any time in such manner as he may determine". The Financial Secretary has in turn instructed the Hong Kong Monetary Authority (HKMA) to manage the Land Fund on a day-to-day basis.

3. The Land Fund is managed by the HKMA as a portfolio separate from the Exchange Fund. Within the HKMA, the Land Fund is managed by the Land Fund Office, which is staffed mainly by professionals formerly employed by the Trustees of the Land Fund Trust. The staff of the Land Fund Office are currently employed by the HKMA on fixed term contracts expiring at the end of 1999.

4. The main investment objective of the Land Fund is to preserve capital and maximise returns while minimising risks. In order to achieve administrative efficiency and economies of scale, the Financial Secretary announced in his Budget Speech in February this year his intention to align the asset allocation and investment policies of the Land Fund and the Exchange Fund by 1 April 1999.

ALIGNMENT OF INVESTMENT POLICIES OF LAND FUND AND EXCHANGE FUND

5. The Financial Secretary has decided to align the investment policies of the Land Fund and the Exchange Fund by merging the assets of the Land Fund into the Exchange Fund in return for the Land Fund receiving consideration equivalent to the market value of its assets as at 31 October 1998. The Land Fund will place the proceeds immediately with the Exchange Fund and enjoy an investment return in exactly the same way as the other fiscal reserves placed with the Exchange Fund. The Land Fund will remain a separate government fund whose only asset will be the receivable due from the Exchange Fund.

6. The merger of the Land Fund assets into the Exchange Fund offers several advantages:

(a) Stable Investment Return

Alignment would achieve a more optimal and stable investment return for the Land Fund in increasingly volatile and unsettled market conditions. For the period from July 1997 to September 1998, during which the market had been exceptionally volatile, the return of the Exchange Fund was higher than that of the Land Fund while the volatility of returns was substantially lower.

(b) Special Dividend

The merger would ensure that the Land Fund moneys will be managed in exactly the same way as other fiscal reserves, all of which are placed with the Exchange Fund. The only reason why the Land Fund has been managed in the form of a separate investment portfolio is due to special circumstances of the transition. Once the Land Fund assets are merged into the Exchange Fund, the Land Fund will enjoy the rate of return achieved by the Exchange Fund as a whole. Under the existing arrangement, the Financial Secretary may declare a special dividend from the Exchange Fund if necessary to maintain the real value of that portion of the fiscal reserves which is kept for monetary purposes. The merger will enlarge the fiscal reserves for special dividend calculation purposes.

(c) Enhanced Operational Efficiency

The merger of the Land Fund's assets into the Exchange Fund would enhance operational efficiency by allowing effective deployment of resources within the HKMA as a whole. Currently, the Land Fund is managed by a separate team of professional investment and supporting staff in the Land Fund Office. Most of the departmental functions in the Land Fund Office are concurrently covered by the equivalent divisions within the Main Office of the HKMA. The staff and many cost savings arising after the alignment can be redeployed to other functional areas within the HKMA.

7. The merger of the Land Fund portfolio into the Exchange Fund in exchange for the Land Fund receiving consideration equivalent to the market value of its assets as at end October 1998 is an investment decision by the Financial Secretary, made pursuant to Clause 7 of the Land Fund Resolution. The Land Fund will remain a separate government fund after the merger. The alignment exercise will not pre-empt consideration of the long-term use of the Land Fund, and any proposal in this regard is subject to approval by LegCo in accordance with the Resolution establishing the Land Fund.

8. In view of the continued unsettled market conditions, it is advisable to proceed with the alignment as soon as practicable. Moreover, the staff of the Land Fund Office would welcome early conversion into permanent terms of employment with the HKMA, which can only take place after the merger of two investment portfolios. Given the large size of the combined portfolio, it will take several months to realign the assets in accordance with a new benchmark to be approved by the Exchange Fund Advisory Committee and to adjust the relevant support systems. We hope to be able to complete this process by 1 April 1999.

VALUATION OF THE LAND FUND

9. The preliminary unaudited assets of the Land Fund totalled HK\$211.4 billion as at 31 October 1998. This figure, subject to audit, will be the consideration received by the Land Fund under the merger.

PUBLICITY

10. A press release will be issued today to announce the merger. This will be accompanied by a background press briefing.

17 November 1998

Finance Bureau

Government Secretariat