立法會
Legislative Council

LC Paper No. CB(1)567/04-05
(These minutes have been seen
by the Administration)

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Panel on Financial Affairs

Minutes of meeting
held on Monday, 1 November 2004 at 9:00 am
in the Chamber of the Legislative Council Building

Members present	**:**	Hon Bernard CHAN, JP (Chairman) Hon Ronny TONG Ka-wah, SC (Deputy Chairman) Hon James TIEN Pei-chun, GBS, JP Hon Albert HO Chun-yan Hon LEE Cheuk-yan Dr Hon David LI Kwok-po, GBS, JP Hon James TO Kun-sun Hon CHAN Kam-lam, JP Hon SIN Chung-kai, JP Hon Emily LAU Wai-hing, JP Hon Abraham SHEK Lai-him, 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 Albert Jinghan CHENG Hon TAM Heung-man
Members attending	:	Hon Mrs Selina CHOW LIANG Shuk-yee, GBS, JP Hon Howard YOUNG, SBS, JP Hon LI Fung-ying, BBS, JP Hon WONG Kwok-hing, MH Hon LEE Wing-tat Hon Patrick LAU Sau-shing, SBS, JP Hon KWONG Chi-kin

Public officers attending : Agenda Item IV

Mr Henry TANG, GBS, JP
Financial Secretary

Mr Frederick MA, JP
Secretary for Financial Services and the Treasury

Mr Alan LAI, GBS, JP
Permanent Secretary for Financial Services and the Treasury (Treasury)

Miss Shirley YUEN
Administrative Assistant to Financial Secretary

Agenda Item V

Mr Joseph YAM, GBS, JP
Chief Executive
Hong Kong Monetary Authority

Mr Norman CHAN, SBS, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Peter PANG, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr CHOI Yiu-kwan, JP
Deputy Chief Executive (Acting)
Hong Kong Monetary Authority

Agenda Item VI

Mrs Millie NG
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)

Mr Nelson MAN
Head, Banking Supervision Division 1
Hong Kong Monetary Authority

Attendance by invitation	**:**	Agenda Item VI Citibank, N.A., Hong Kong Mr Atul MALIK Country Business Manager Hong Kong & Macau Ms Prudence HUANG Chief Financial Officer Hong Kong and Macau Mrs Betty TSOI Director, Corporate Quality Hong Kong & Asia Pacific Region Allen & Overy Mr Simon BERRY Partner KPMG Mr Charles KINSLEY Principal
Clerk in attendance	**:**	Miss Salumi CHAN Chief Council Secretary (1)5
Staff in attendance	**:**	Ms Connie SZETO Senior Council Secretary (1)4 Ms May LEUNG Legislative Assistant Agenda Item VI Ms Bernice WONG Assistant Legal Adviser 1

Action

I. Confirmation of minutes of meeting

(LC Paper No. CB(1)87/04-05 — Minutes of meeting on 12 October 2004)

The minutes of the meeting held on 12 October 2004 were confirmed.

II. Information paper issued since last meeting

2. Members noted that no information paper had been issued since the last meeting held on 12 October 2004.

III. Date of next meeting and items for discussion

(LC Paper No. CB(1)103/04-05(01) — List of outstanding items for discussion

LC Paper No. CB(1)103/04-05(02) List of follow-up actions)

Special meeting on 11 November 2004

3. The Chairman reminded members that a special meeting had been scheduled for Wednesday, 10 November 2004, at 10:45 am to discuss the following items:

(a) Briefing on proposed amendments to the Securities and Futures Ordinance; and

(b) Briefing on the Personalized Vehicle Registration Marks Scheme to be contained in the Revenue Bill 2005.

Regular meeting on 6 December 2004

4. The Chairman referred members to the "List of outstanding items for discussion". He pointed out that the next briefing by the Financial Secretary (FS) on the latest overall economic situation in Hong Kong would be held in December 2004. Apart from that, Dr David LI and the Administration had proposed one and five items for discussion in December 2004 respectively.

5. To allow sufficient time for the discussion of the seven items, the Chairman proposed and members agreed that the regular meeting on 6 December 2004 be held from 9:00 am to 12:45 pm to discuss the following items:

(a) Briefing by the Financial Secretary on Hong Kong's latest overall economic situation;

(b) Briefing on the draft Banking (Amendment) Bill 2005;

(c) Proposal for contribution to the 8th replenishment of the Asian Development Fund; and

(d) Proposed creation and deletion of one permanent Chief Systems Manager post.

6. On paragraph 5(a), members noted that FS would brief Members on Hong Kong's latest overall economic situation. On paragraph 5(b), the Administration would brief the Panel on the major provisions of the draft Banking (Amendment) Bill 2005, which was to implement the New Basel Capital Accord in Hong Kong. On paragraph 5(c), the Administration would consult the Panel on the proposal for contribution to the 8th replenishment of the Asian Development Fund before submitting the proposal to the Finance Committee in January 2005. As regards paragraph 5(d), members noted that the Administration would consult the Panel on the proposal to create one permanent Chief Systems Manager (CSM) post in the Inland Revenue Department, which would be offset by deleting one permanent CSM post in the Office of the Government Chief Information Officer. The Administration planned to submit the proposal to the Establishment Subcommittee in January 2005.

Special meeting on 17 December 2004

7. The Chairman consulted members on whether the following three items should be discussed at a special meeting in December 2004 or at the meeting in January 2005:

(a) Briefing on the draft Industrial and Commercial Bank of China (Asia) Limited (Merger) Bill;

(b) Progress of public consultation on proposed measures to address risks arising from securities margin financing; and

(c) Outcome of review of the levies of the Investor Compensation Fund.

8. On paragraph 7(a), members noted that Dr David LI would brief the Panel on the draft of the Industrial and Commercial Bank of China (Asia) Limited (Merger) Bill (ICBC Merger Bill). On paragraph 7(b), members noted that the Administration would report on the progress of the public consultation on the proposed measures to address risks arising from securities margin financing. As regards paragraph 7(c), the Administration would report on the outcome of the review of the Investor Compensation Fund, including the introduction of a levy adjustment mechanism. The Administration had previously undertaken to brief the Panel on the subject by end of 2004.

9. Responding to some members, the Clerk advised that upon enquiry by the LegCo Secretariat, the Administration had indicated that there might be one discussion item proposed for the regular meeting to be held in January 2005.

10. Dr David LI said that he would like to brief members on the draft of the ICBC Merger Bill in December 2004 and then introduce the Bill into LegCo in early 2005.

11. Ms Emily LAU considered that a special meeting should be held in December 2004 for the discussion of the three items mentioned in paragraph 7 above. Mr James TIEN opined that special meetings should be held only under special circumstances.

12. After discussion, members agreed that a special meeting be held on Friday, 17 December 2004, from 8:30 am to 10:30am to discuss the three items mentioned in paragraph 7 above.

Regulatory framework for addressing analyst conflicts of interests

13. Ms Emily LAU noted that the Securities and Futures Commission (SFC) had published a consultation paper on the captioned subject in March 2004 and would publish the consultation conclusions soon. She enquired whether the Administration had any plan to brief the Panel on the subject. The Chairman directed the Clerk to check with the Administration.

> (*Post-meeting note:* SFC published the "Consultation conclusions on the regulatory framework for addressing analyst conflicts of interest" on 3 November 2004. The document was circulated to members vide LC Paper No. CB(1)172/04-05 on 4 November 2004. The Administration indicated that SFC was pleased to brief members on the subject if invited by the Panel. Upon the Clerk's enquiry, Ms Emily LAU confirmed in mid-November that there was no need to arrange for the Panel to be briefed on the subject at the present stage.)

IV. The 2005-06 Budget consultation

Briefing by the Financial Secretary

14. At the invitation of the Chairman, the Financial Secretary (FS) gave a power-point presentation on the background information for the 2005-06 Budget consultation. An information pack and an information note on the subject were tabled at the meeting.

> (*Post-meeting note:* The information pack for the Financial Secretary's consultations on the 2005-06 Budget and the information note on 2005-06 Budget consultation were circulated to members vide LC Paper

Nos. CB(1)103/04-05(03) and CB(1)146/04-05(01) respectively on 2 November 2004.)

15. FS highlighted the following points:

(a) On economic positioning of Hong Kong, the Administration's broad principles were to leverage on the Mainland, capitalize on opportunities offered by the Closer Economic Partnership Arrangement (CEPA); uphold the "Market leads, Government facilitates" principle; build on Hong Kong's strengths and enhance competitiveness of key industries; develop Hong Kong's human resources and promote job opportunities; and maintain a robust market structure (Chart 2 of the information pack).

(b) The Hong Kong economy was on a broad-based upturn in the second quarter of 2004 and was expected to maintain robust growth. The forecast Gross Domestic Product (GDP) growth rate for 2004 had been adjusted upward from 6% in March 2004 to 7.5%, and the forecast Composite Consumer Price Index for 2004 from -1% in March 2004 to 0%. Despite the robust economic outlook, there were uncertainties affecting the external economic environment, including surging crude oil prices, rising interest rates in the United States (US), and the macroeconomic adjustment measures in the Mainland. In the domestic sector, there were also uncertainties in the pace of job creation and asset market developments (Charts 3 - 7).

(c) On the management of public finance, the consolidated deficit and operating deficit were $40.1 billion and $28.6 billion respectively in 2003-04. In the 2004-05 Budget, while it was expected that the consolidated deficit would decline and a surplus of $6 billion would be recorded in 2008-09, the operating account would still record a deficit. Despite a promising rate of economic return, operating revenue would still fall short of matching in full the operating expenditure (Charts 8 - 10). The Government was committed to restoring fiscal balance in the Operating and Consolidated Accounts by 2008-09, bringing public expenditure down to 20% of GDP or below, and reducing operating expenditure to $210.6 billion in 2005-06 and to $200 billion by 2008-09 (Chart 12).

(d) On Government expenditure, an average of around $29 billion a year would be allocated on capital works projects for the period up to 2008-09 (Chart 13). As regards recurrent expenditure, expenditure on education, social welfare, health and security together had accounted for nearly 67.4% of the total recurrent spending in 2004-05 (Chart 14). The growth in total recurrent expenditure had increased by 82% over the past ten years, while recurrent spending on education and social welfare had outpaced other policy areas, with growth at 88% and 236% respectively (Chart 15). The increase in social welfare recurrent expenditure excluding social security payments was 193%.

(e) On the revenue side, profits tax and income tax on individuals (i.e. salaries tax, personal assessment and property tax) were the two most important sources of revenue for 2004-05 accounting for some 40.4% of Government's total revenue (Chart 16). Total operating revenue, including taxes, stamp duties and government fees and charges had only increased by 9.4% over the past ten years. Capital revenue, such as land premium, and investment income had fluctuated a lot and could not be relied upon to solve the operating deficit (Chart 17).

(f) The share of salaries tax revenue contributed by the top 300 000 taxpayers was estimated to rise from 79.9% in 1997-98 to 85% in 2004-05. The share contributed by the top 100 000 taxpayers had increased from 54.8% in 1997-98 to 61.1% in 2002-03. On the other hand, the share contributed by the last 300 000 in the first million taxpayers was estimated to reduce from 3.6% in 1997-98 to 1.6 % in 2004-05. The phenomenon had signified an increasing reliance on high-income earners in salaries tax revenue (Chart 11). While the phenomenon reflected the principle of "those who have the means pay more", there was doubt about whether the principle of "equitable sharing of the tax burden" was achieved. The Government required a broader, sizable and steady income source to underpin its revenue and meet its expenditure requirements.

(g) On measures to broaden the tax base, a broad-based Goods and Services Tax (GST) was a reasonable and equitable way to smooth out bumps in revenue stream and secure fiscal stability for the future. The Government had set up an internal committee to conduct a comprehensive study on GST in Hong Kong. The committee would submit its report to FS by the end of 2004 and the Government would then decide on the way forward. The public was invited to give views on the need of introducing other taxes, such as Capital Gain Tax, World-wide Tax, Green Tax, etc (Chart 18).

(h) As regards existing taxes, the Government was conducting a review on estate duty and had invited public views on the review. The Government would also invite public views on whether the duty on alcoholic beverages should be modified. Decisions on these two taxes would be announced in the 2005-06 Budget (Chart 19).

(i) The government bonds offering exercise in July 2004 had raised $20 billion for funding infrastructural projects in Hong Kong (Chart 20).

The Government was open-minded on whether bonds offering exercise would be conducted again in future.

16. FS said that he would start consulting LegCo Members and representatives from various sectors of the community in the coming months in preparing for the 2005-06 Budget. He welcomed advice and suggestions from Members and the public. A website had been set up to receive written submissions for this purpose.

Discussion

Uncertainties in external economic environment

17. Mr James TIEN enquired about the impacts of surging crude oil prices and recent increase in Renminbi (RMB) interest rate on Hong Kong's economy. On the surging crude oil prices, FS advised that according to economic analysis, an increase of US$10 per barrel of oil for a continuous period of 12 months could reduce global economic growth by 0.4% to 0.8%. The actual impact on each economy would depend on its respective oil dependency ratio. As Hong Kong's oil dependency ratio was not high, the direct impact on the economy would not be significant. The indirect impact would depend mainly on whether the rise in oil prices would dampen the demand of Hong Kong's important trading partners, namely the US and the Mainland. It was envisaged that the impact on the Mainland economy would be more significant. As regards the increase of RMB interest rate by 27 basis point on 29 October 2004, FS said that RMB bank lending rates were basically determined by the market. Coupled with the implementation of the macroeconomic adjustment measures in the Mainland, there could be more uncertainties in the external economic environment.

Management of public finance

18. Mr CHAN Kam-lam expressed concern about further depletion of the level of fiscal reserves to $167.3 billion by 31 March 2009, which would be equivalent to only eight months of Government expenditure. He sought FS' view on the appropriate level of fiscal reserves to be maintained.

19. FS said that for the Government to remain in a healthy state of public finance, the fiscal reserves should be maintained at a level equivalent to at least 12 months of government expenditure. As such, it would be unacceptable for the level of reserves to fall to $167.3 billion by 31 March 2009. The projection had indicated the urgency for the Administration to address the deficit problem so as to stop further depletion of the fiscal reserves.

20. Mr James TIEN also expressed concern about the level of fiscal reserves and the deficit problem. He urged that the Administration should step up its efforts in identifying savings and enhancing productivity in the public sector.

21. Mr CHIM Pui-chung pointed out that under Article 107 of the Basic Law (BL 107), the Government was required to achieve fiscal balance and avoid deficits. He was concerned whether the Government had contravened the Basic Law and how it could achieve fiscal balance in the long run. In this connection, Mr WONG Ting-kwong enquired about the progress of eliminating deficit in the operating account.

22. FS advised that the Government had set a clear target in the 2004-05 Budget to restore fiscal balance in the Operating and Consolidated Accounts by 2008-09. While the public generally indicated their support for the broad directions set out in that Budget, they considered that the Administration should adopt a pragmatic and measured approach in tackling the deficit problem. In order to address the operating deficit, the Administration had stepped up its efforts in containing and reducing public expenditure. The Administration was cautiously optimistic about achieving the target by 2008-09. FS also pointed out that under BL 107, the Government was required to "strive" to achieve fiscal balance and avoid deficits. He believed that the Government's fiscal policy was consistent with the principle enshrined in BL 107.

Tax relief for the middle class

23. Mr CHAN Kam-lam indicated support for the Administration to adhere to the principle of "those who have the means pay more" in formulating revenue measures in the 2005-06 Budget. He however expressed concern about the tax burden on the middle class and urged the Administration to address the issue.

24. Mr SIN Chung-kai and Mr James TIEN noted that as a result of economic recovery, the revenue for the first six months of 2004-05 had reached over $90 billion as compared to about $40 billion in the same period of 2003-04. Given the increase in Government income, they considered that there was room for the Administration to review the salaries tax increases implemented in 2003-04 and 2004-05 so as to relieve the tax burden of the middle class. However, Mr Albert CHENG said that he did not support restoring salaries tax to the 2002-03 level.

25. FS advised that while the securitization of future toll-revenue of five tunnels and one bridge and the issuance of Government bonds had raised a total revenue of $26 billion, and the income from land premium was expected to exceed the original forecast in the 2004-05 Budget, such incomes were non-recurrent in nature and subject to volatility. He also pointed out that due to uncertainties in the global investment environment, it was not optimistic that the target investment returns of $12 billion for the fiscal reserves placed with the Exchange Fund set in the 2004-05 Budget would be met. FS stressed that it was not prudent to rely on capital revenue for financing recurrent expenditure of the Government. Given the recent recovery in Hong Kong's economy, it was an appropriate time for the public to discuss issues on broadening the tax base and introducing new taxes. As regards whether there should be measures to provide tax relief for the middle class in the 2005-06 Budget, FS

re-iterated that he welcomed views and advice from Members and the public on the subject.

26. Mr SIN Chung-kai suggested that the Administration should disclose information on Government revenue including breakdowns on income from various revenue sources during the interim of a financial year with a view to enhancing the transparency of Government's financial position. FS pointed out that the current arrangement for provision of financial information complied with international standards, and that it might not be appropriate to provide too detailed interim information on Government income and expenditure given their fluctuation during the year.

Broadening Hong Kong's tax base

27. While agreeing that the Government should explore means to broaden the tax base, Mr CHAN Kam-lam expressed reservation that GST was a suitable measure to tackle the deficit problem. In this connection, Mr KWONG Chi-kin considered that the Administration should not use the phenomenon in Chart 11 (i.e. an increasing reliance on high-income earners in salaries tax revenue) as a justification for introducing GST. Mr Albert CHENG stated that he did not support the introduction of GST.

28. Mr Ronny TONG pointed out that the phenomenon in Chart 11 could be the result of decreasing income earned by taxpayers in the low-income group. He considered that the Administration should take into account the income and expenditure profiles of various groups of taxpayers before drawing a conclusion. In order to better comprehend the situation, Ms Emily LAU suggested that the Administration should compile information on the distribution of income among various sectors of the community and various segments of the workforce.

29. On the issue of increasing reliance on high-income earners for contribution to salaries tax, FS pointed out that as shown in Chart 11, the contribution made by the second to third 100 000 taxpayers had increased from 25.1% in 1997-98 to 28% in 2004-05. It was a matter for public discussion as to whether it was fair to require this small group of taxpayers to continue to contribute a significant share in the tax revenue and whether changes should be introduced in the taxation regime. As regards Ms Emily LAU's suggestion mentioned in paragraph 28 above, FS said that since Hong Kong did not impose any control on the flow of capital and given the need to protect privacy, it would not be appropriate nor feasible for the Administration to compile the required information.

30. Mr Albert CHENG pointed out that in the absence of a progressive tax system, high-income earners were not required to pay more taxes. He expressed support for the Government to introduce a progressive tax regime in respect of profits tax. Mr LEE Cheuk-yan shared this view.

31. Mr Ronny TONG suggested that the Government should consider introducing a progressive tax regime in respect of salaries tax so as to be consistent with the principle of "those who have the means pay more".

32. Miss Mandy TAM concurred that the problem of uneven distribution of wealth between the rich and the poor had deteriorated in recent years. She opined that the Government should consider revising the salary tax rates so that those earning extremely high income would be required to pay more taxes.

33. On the appropriateness for Hong Kong to adopt a progressive tax regime, FS said that at present, salaries tax was already levied on a progressive basis under which the tax rate would increase with an increase in taxpayers' income. In respect of profits tax, the tax rate had been revised upward from 16% to 17.5% in 2003-04. At present, about 60% of the profits tax revenue was contributed by top 500 contributing corporations.

34. Ms Emily LAU, Mr Albert HO and Mr KWONG Chi-kin suggested that the Administration should consider imposing a tax on luxury property. In reply, FS explained that under the current arrangement, the stamp duty payable upon the transaction of a property increased with the price of the property. To avoid double-taxing the buyers concerned, the Administration had no plan to introduce a separate tax on luxury property.

35. On the review of existing taxes, Mr KWONG Chi-kin expressed support for reducing the duty on beer, but he had reservation about reducing the duty on wine. He also considered it not justified to abolish the estate duty. Miss Mandy TAM considered that the abolition of estate duty would be inconsistent with the Administration's objective of broadening the tax base.

36. FS clarified that in the 2004-05 Budget, he had undertaken to conduct a review on the estate duty and present the findings in the 2005-06 Budget. A consultation was carried out in July 2004, and the Administration was still analyzing and considering the views collected during the consultation exercise. He stressed that no decision had been made on the subject.

Addressing the problem of widening gap between the rich and the poor

37. Ms Emily LAU, Mr Albert HO, Mr LEE Cheuk-yan and Mr Ronny TONG expressed concern over the problem of widening gap between the rich and the poor in Hong Kong. They were of the view that the problem had led to decreasing tax revenue from the low-income group shown in Chart 11. They called on the Administration to put forward measures in the Chief Executive (CE)'s Policy Address 2005 and the 2005-06 Budget to tackle the problem. Mr HO further enquired whether the Administration would consider adopting indicators, such as a poverty line, to measure the problem and setting a target for improvement.

38. FS pointed out that given the advent of globalization and the development of knowledge-based economy, poverty had become a common problem in many economies. He re-iterated that the Government was committed to providing a suitable environment to promote investment, to facilitate business and to encourage the creation of wealth by the more capable people in the community so that they could contribute more to government revenue. The Government would also continue to invest in education to facilitate the younger generation and the working population to face up to the challenges of the knowledge-based economy. On the other hand, the Government was keen to ensure that the disadvantaged would be taken care of. The provision of social services had helped the needy to improve their livelihood.

39. Mr LEE Cheuk-yan was concerned that the general public was unable to share the benefits of Hong Kong's economic recovery. Given the recent improvement in the Government's financial position, Mr LEE urged that the Government should not propose further expenditure cuts on education, welfare and health services in the 2005-06 Budget and should consider reverting the Comprehensive Social Security Assistance payments to the level before June 2003. Mr Albert CHENG considered that there was an urgent need for the Administration to assist the less privileged in the community.

40. FS stressed that the Administration was aware of the public concern about the poverty problem. He said that it would be a priority of the Government to tackle the problem in the CE's Policy Address 2005 and the 2005-06 Budget. The Administration welcomed views and suggestions from Members and the public on the subject.

Addressing the unemployment problem and developing the economy

41. While expressing support for the Government to develop Hong Kong's human resources and promote job opportunities, Mr WONG Kwok-hing was concerned that the problems of unemployment in the construction sector, unemployment of middle-aged workers and decreasing income for low-waged workers had deteriorated. He urged that the Government should take action to create more job opportunities, and encourage and assist the unemployed to find jobs. Mr LEE Wing-tat enquired whether the Administration would set targets for improving the unemployment problem in the 2005-06 Budget.

42. In response, FS stressed that as Hong Kong was still undergoing economic re-structuring, the Administration recognized that continuous growth in the Mainland economy and increasing economic integration between Mainland and Hong Kong would provide opportunities for Hong Kong as well as pose challenges for solving the unemployment problem. FS pointed out that the Economic and Employment Committee was collaborating with the business community and labour sector to actively pursue measures to assist the unemployed to find jobs. It was the Government's role to facilitate the market, while the private sector was the main provider of jobs. With a view to assisting the low-education and less-skilled workers to find jobs, FS advised that the Administration would continue to develop the tourism industry to promote employment in the sector. He further pointed out that the re-affirmation of the Administration's policy that the demand and supply of housing should be market-led had contributed to the revival of the property market and hence eased the unemployment problem in the construction sector to a certain extent.

43. Mr WONG Kwok-hing expressed concern that the importation of prefabricated building components by developers had undermined the employment opportunities of local construction workers. FS pointed out that the industry adopted such a practice for lowering the production costs. In order to protect the interest of local workers, FS emphasized that the Administration would step up its efforts to combat illegal employment in the construction industry.

44. Noting that it was the Administration's aim to enhance competitiveness of the core industries, Ms LI Fung-ying enquired about the measures to be taken by the Administration for promoting these industries. FS advised that it was important for Hong Kong to understand its competitive advantages in mapping out the strategies for economic development. Financial services, producer services, logistics and tourism were among the core industries of Hong Kong. The Administration would facilitate the development and expansion of these industries with a view to creating more employment opportunities for local workers.

V. Briefing on the work of the Hong Kong Monetary Authority

(LC Paper No. CB(1)103/04-05(04) — Power-point presentation material provided by the Hong Kong Monetary Authority)

Briefing on the work of the Hong Kong Monetary Authority

45. At the invitation of the Chairman, the Chief Executive of the Hong Kong Monetary Authority (CE/HKMA) gave a power-point presentation on HKMA's key areas of work. CE/HKMA highlighted the following points:

(a) On currency stability, the Hong Kong dollar strengthened markedly in the third quarter of 2003. The market exchange rate converged to the linked rate in the second quarter of 2004 but strengthened again in mid-October 2004 upon speculation about the introduction of a more flexible Renminbi (RMB) exchange rate regime. The Aggregate Balance declined from a peak of $54 billion in the second quarter of 2004 to $8.6 billion on 27 October 2004. Given the strong economic recovery in Hong Kong and the continued speculation about revaluation of RMB, it might take more time for the Aggregate Balance to be reduced to its more normal level of around $500 million.

(b) Important external factors affecting risks and vulnerabilities of the Hong Kong dollar included the pace of global economic recovery in the light of surging oil prices, upturn in interest rates in the United States (US), political pressure on RMB exchange rate, and implementation of macroeconomic policies of the Mainland. Internally, robust economic recovery, strong international investment position, ending of 68-month long deflation, and easing unemployment rate had contributed to the strengthening of the Hong Kong dollar.

(c) On the banking sector performance, although bank lending had risen recently, the liquidity of retail banks remained high. On the back of improving economic conditions and asset quality, the bad debt charge declined notably. The extent of negative equity problem had eased along with the rise in property prices. The number of residential mortgage loans in negative equity had reduced from the peak of around 106 000 cases in June 2003 to around 25 400 cases in September 2004, representing a reduction of about 75%.

(d) On protection of the interest of bank customers, HKMA took a serious view of the recent incident of destruction of rented safe deposit boxes by DBS Bank (Hong Kong) Limited (DBS Bank) and had required the Bank to conduct a thorough investigation into the incident, compensate the affected customers, and take a range of remedial actions. HKMA would study the DBS Bank's investigation report in due course and consider whether there were any lessons that should be shared with banks providing safe deposit box service. Meanwhile, HKMA had requested all authorized institutions (AIs) to undertake a comprehensive review of terms and conditions for safe deposit service by 15 November 2004 and for other banking services by 15 January 2005 so as to ensure that they were consistent with the Code of Banking Practice. HKMA was also exploring with the Code of Banking Practice Committee on how the current practice in relation to AI's use of exemption of liability clauses in the provision of banking services could be improved in the context of the Code. On the other hand, in response to increasing number of internet frauds relating to fake bank e-mails and websites, HKMA had requested banks to strengthen their internet banking security and step up consumer education to enhance customers' awareness of the issue.

(e) On work projects in the banking sector, preparatory work for the implementation of the New Capital Accord (Basel II) by the end of 2006 was underway. The Panel was briefed on the broad concept in July 2004 and would be updated on the work progress at its meeting to be held in December 2004. Other projects including Deposit Protection Scheme, sharing of positive customer credit data and the Commercial Credit Reference Agency (CCRA) Scheme were progressing well.

(f) As regards development in financial infrastructure, the Clearing and Settlement Systems Ordinance enacted in July 2004 would commence operation in early November 2004. The Ordinance would strengthen HKMA's oversight of important clearing and settlement systems and provide settlement finality to the transactions effected through such systems. The Hong Kong dollar and US dollar Real Time Gross Settlement linkages between Guangdong and Hong Kong, and US dollar cheque two-way clearing between Shenzhen and Hong Kong were implemented in March and July 2004 respectively. Since the launching of personal RMB business in Hong Kong, there had been steady increase in the use of RMB debit and credit cards by Mainland tourists in Hong Kong. The total outstanding RMB deposits in Hong Kong was about RMB$7.5 billion by the end of August 2004.

(g) Regarding the performance of the Exchange Fund (EF), investment income for 2004 up to the end of September 2004 was $23.7 billion. The share of return for the fiscal reserves placed with EF was $6 billion. In view of the difficult investment environment, the investment outlook of EF for the rest of 2004 was full of challenges. As such, it might be difficult to meet the target investment return of $12.3 billion for the fiscal reserves set out in the 2004-05 Budget.

(*Post-meeting note:* Updated pages of the power-point presentation material were circulated to members vide LC Paper No. CB(1)146/04-05 on 2 November 2004.)

Discussion

Linked Exchange Rate System and stability of Hong Kong dollar

46. Given the increasing acceptance of RMB for retail transactions in Hong Kong and the growing economic integration between the Mainland and Hong Kong, Mr Andrew LEUNG was concerned whether the role of Hong Kong dollar would be marginalized and Mr CHIM Pui-chung enquired whether Hong Kong dollar would be pegged with RMB. As the US dollar had fallen substantially against the Euro since 2003, Mr CHIM also enquired whether Hong Kong dollar would be pegged with Euro.

47. CE/HKMA said that even when the US dollar was strong, Hong Kong dollar had not been marginalized by the US dollar. In fact, it was too early to say whether Hong Kong dollar would be marginalized by RMB because RMB was not fully convertible and Mainland's capital accounts were not yet liberalized. The increasing use of RMB in Hong Kong would unlikely diminish the role of Hong Kong dollar or pose risks on its stability. In this connection, it was stipulated in the Basic Law that the Hong Kong dollar, as the legal tender in Hong Kong, should continue to circulate.

48. Mr Andrew LEUNG enquired whether the Administration would review the Linked Exchange Rate (LER) System. CE/HKMA advised that the LER System was the cornerstone of Hong Kong's monetary system and had contributed to maintaining the stability of Hong Kong dollar since its implementation in 1983. Under the monetary policy objective determined by the Financial Secretary (FS), currency stability was defined as a stable external exchange value of Hong Kong dollar in terms of its exchange rate against US dollar at around HK$7.8 to US$1. The Monetary Authority (MA) was responsible for achieving the policy objective. CE/HKMA stressed that in view of the small size and external-oriented nature of Hong Kong's economy, a stable currency maintained under the LER System was vital for Hong Kong to withstand external volatility. Given that US dollar was a strong and powerful currency in the global financial market and that RMB exchange rate was linked to US dollar to some extent, the increasing use of RMB in Hong Kong and the increase in the flexibility of RMB exchange rate should not undermine the Administration's determination to maintain the LER System. Nevertheless, HKMA CE/HKMA said that he would convey members' concerns to FS. He also cautioned that issues relating to the monetary and exchange rate systems for Hong Kong were extremely market sensitive. While HKMA had conducted a number of in-depth researches on related subjects, it was not appropriate for HKMA to disclose the details given the sensitivity of the issues involved.

49. Ms Emily LAU was pleased to note that HKMA had conducted researches on the LER System. She pointed out that at the Panel meeting held on 19 July 2002, members had agreed with her proposal for the Research and Library Services Division of the LegCo Secretariat to conduct a research on the LER System. However, due to market speculations on the implications of the proposed research, the Panel had subsequently decided at its meeting on 20 September 2002 to shelve the proposed research. Ms LAU considered that the Panel might revisit the idea of conducting a research on the LER System in due course.

50. With continuous growth of RMB business in Hong Kong and with a view to promoting external investment in Hong Kong, Mr James TIEN suggested that the Administration should explore the feasibility of relaxing the criteria of the Capital Investment Entrant Scheme to admit people from the Mainland making investments in Hong Kong using RMB.

51. CE/HKMA said that while he supported Mr TIEN's suggestion in principle, the suggestion would be subject to the pace of liberalization of capital accounts on the Mainland. It was envisaged that progressive liberalization of Mainland's capital accounts would facilitate capital flows between the Mainland and Hong Kong. CE/HKMA added that in order to facilitate trade and capital flows between the Mainland and Hong Kong, HKMA was actively exploring the feasibility of establishing a Real Time Gross Settlement System for RMB in Hong Kong to gradually build up the infrastructure for RMB in Hong Kong so as to capture any intermediation activities in the future when the Mainland liberalized its capital markets.

52. Mr CHAN Kam-lam expressed concern about the uncertainties in the external environment affecting the stability of Hong Kong dollar. Pointing out that the LER System was operated under a Currency Board System (CBS) under which HKMA only acted passively in selling or purchasing Hong Kong dollar or US dollar as appropriate in response to capital inflow or outflow, Mr CHAN was concerned how the stability of Hong Kong dollar could be maintained under the LER System. He further enquired whether HKMA would consider cooperating with regulators in the financial market to curb speculative attacks on Hong Kong dollar.

53. In response, CE/HKMA re-iterated that the LER System had contributed to maintaining the stability of Hong Kong dollar and the confidence in the currency. He explained that the LER System was operated according to a rule-based CBS under which the MA was given little discretionary power. At present, while there was a formal Convertibility Undertaking for HKMA to sell US dollar against Hong Kong dollar clearing balances of licensed banks at the fixed rate of 7.8, there was no formal Convertibility Undertaking on the strong side of the Link to buy US dollar. HKMA had the discretion to determine at which level of the exchange rate it should sell Hong Kong dollar against US dollar when the exchange rate was on the strong side of the Link. HKMA's actions to purchase securities from the market for defending Hong Kong dollar against speculative attacks in 1998 and its actions to sell Hong Kong dollar in response to capital inflows in late 2003 and early 2004 had demonstrated the need for HKMA to retain some discretionary power in the operation of CBS. However, there were pros and cons for retaining the discretionary power. On the one hand, the constructive ambiguity inherent in the discretion inhibited speculative shorting of Hong Kong dollar. On the other hand, the total absence of discretionary power might enhance further credibility of the system. The Sub-Committee on Currency Board Operations of the Exchange Fund Advisory Committee (EFAC) had discussed issues relating to the need for HKMA to retain the discretionary power and had affirmed such need for the purpose of maintaining the stability of Hong Kong dollar. The Sub-Committee had also conducted reviews on market operations of HKMA with a view to improving the operation of CBS.

Investment returns of Exchange Fund

54. Ms Emily LAU noted that according to HKMA's forecast, the target investment return of $12.3 billion for the fiscal reserves placed with EF set out in the 2004-05 Budget might not be met. Given that the investment return of EF reflected the performance of HKMA in managing EF, Ms LAU enquired about the impact of achieving or not achieving the target on the annual pay review of HKMA's staff, including the pay level of CE/HKMA.

55. In reply, CE/HKMA stressed that $12.3 billion was only a target set out in the Budget. It would be impossible to make an accurate estimate on such target as the investment income of EF was subject to volatility and uncertainties in the global financial market. In this connection, he pointed out that while the target investment return for the fiscal reserves placed with EF set out in the 2003-04 Budget was $12.1 billion, the actual return for 2003 was $25.7 billion. CE/HKMA considered it more appropriate to compare the investment income of EF with that of the benchmark portfolio determined by EFAC. If EF's investment income for a year exceeded the benchmark, it reflected that HKMA had done a good job in managing EF for that particular year. CE/HKMA also pointed out that the pay levels of HKMA's staff were determined by FS on the recommendations by the Governance Sub-Committee of EFAC. Given that the functions and responsibilities of HKMA covered many areas including the management of EF, the Sub-Committee would assess the overall performance of HKMA in making its recommendations.

56. Mr SIN Chung-kai expressed the Democratic Party's view that given the increase in the level of EF since 1998, the share of investment return for the fiscal reserves placed with EF should be increased. He also suggested that the Administration should consider deploying part of EF's net investment income gained for a year to meet Government expenditure.

57. On the suggestion of using part of EF's net investment income for meeting Government expenditure, CE/HKMA advised that as provided under the Exchange Fund Ordinance (EFO) (Cap. 66), EF was under the control of FS. The EFO also provided that apart from using EF for its primary purpose, FS might, with a view to maintaining Hong Kong as an international financial centre, use EF as he thought fit to maintain the stability and the integrity of the monetary and financial systems of Hong Kong. Moreover, FS might, after consulting EFAC and in accordance with section 8 of EFO, transfer from EF to the General Revenue any sum or part of any sum where he was satisfied that such transfer was not likely to affect adversely his ability to fulfil any purpose for which EF was required to be or might be used under EFO. As regards the appropriate level of EF to be maintained, CE/HKMA stressed that given the volatility in the global financial market and that Hong Kong was a small and externally oriented economy, a sizable EF was vital for Hong Kong to withstand currency attacks and external shocks. In his view as the MA, it was necessary to adopt a prudent approach in maintaining the level of EF.

Destruction of rented safe deposit boxes by DBS Bank

58. Ms Emily LAU expressed grave concern on the recent incident of destruction of rented safe deposit boxes by DBS Bank. She enquired about the follow-up actions taken by HKMA and whether HKMA would consider conducting its own investigation into the incident.

59. CE/HKMA reiterated that HKMA took the incident seriously and had required DBS Bank to conduct a thorough investigation into the incident, compensate the affected customers, and take a range of remedial actions. As at 29 October 2004, DBS Bank had settled 55 cases involving 26 customers who had accepted $150,000 for full settlement and 29 customers who had been compensated with their claims filed to the bank. As regards the 28 unsettled cases, seven customers had submitted claims which were being considered by DBS Bank, while 21 customers were either in process of preparing their claims with the Bank or considering their cases. CE/HKMA also pointed out that HKMA was studying the internal report submitted by DBS Bank. Key findings and conclusions of the report had been disclosed by DBS Bank in its press release issued on 29 October 2004. Moreover, DBS Bank had commissioned an independent auditor to investigate the incident. HKMA would carefully examine the auditor report to be submitted by the Bank. After reviewing the internal report and the auditor report, HKMA would, if considered necessary, conduct its own investigation into the incident.

60. Mr LEE Cheuk-yan noted that banks providing safe deposit box service generally included an exemption of liability clause in their contract with customers (page 30 of the presentation material). Some of these clauses purported to exclude or restrict a bank's liability even in the case of loss or damages caused by negligence of the bank or its staff. However, under section 7(2) of the Control of Exemption Clauses Ordinance (CECO) (Cap. 71), a party to a contract could not by reference to any contract term excluded or restricted his liability for negligence except in so far as the term or notice satisfied the requirement of reasonableness. Section 5.5 of the Code of Banking Practice (the Code) also provided that, in drawing up their terms and conditions for banking services, AIs should have due regard to applicable laws in Hong Kong, including the CECO. Mr LEE therefore queried whether the exemption of liability clause had breached the Code. He further enquired whether HKMA would review all exemption of liability clauses contained in contracts entered between AIs and their customers.

61. CE/HKMA advised that there were provisions in statutory guidelines issued by HKMA and the Code requiring AIs to put in place sound and effective systems for safeguarding interests of their customers and properly managing risks arising from their business operations. AIs were required to ensure that exemption of liability clauses were used appropriately in their contracts with customers and that the clauses were consistent with the relevant provisions of the CECO which contained a "reasonableness" element. The DBS incident had revealed that there was room for improvement in this area. To this end, HKMA had requested all AIs to undertake a comprehensive review of their terms and conditions for banking services to see if they were consistent with the Code and to consider whether any amendments were

necessary. AIs were required to submit their report in respect of safe deposit box service by 15 November 2004 and that in respect of other banking services by 15 January 2005. HKMA would then review AIs' findings and follow up with individual institutions to ensure that any necessary amendments to their terms and conditions were implemented. Meanwhile, HKMA was also exploring with the Code of Banking Practice Committee on how the current practice in relation to AIs' use of exemption of liability clauses could be improved in the context of the Code.

HKMA

62. Ms Emily LAU requested that information on the outcome of HKMA's review of AIs' findings be provided to the Panel in due course.

(*Post-meeting note:* The outcome of HKMA's review of AIs' findings in respect of terms and conditions for safe deposit box was issued to members vide LC Paper No. CB(1)546/04-05 on 20 December 2004.)

63. Mr LEE Cheuk-yan was concerned that the exemption of liability clause used in DBS Bank's safe deposit box contract could exclude the bank's liability to the customers affected by the incident. Mr Ronny TONG considered that it was the duty of HKMA to protect the interests of the customers concerned. HKMA should examine whether the clause had breached the Code and inform the public of the result.

64. CE/HKMA advised that in respect of the DBS incident, HKMA was of the view that the exemption of liability clause in the bank's contract with customers appeared to be inconsistent with the CECO and had apparently breached the Code. HKMA had informed DBS Bank and the public of its view. As regards whether AIs could rely on exemption of liability clauses used in banks' contracts in litigation over claims by customers, it was a matter for the court to decide having regard to the circumstances of individual cases.

Fake bank websites

65. Mr LEE Wing-tat expressed concern about the increasing number of fake bank e-mails and websites reported recently in Hong Kong and enquired about the follow-up actions taken by HKMA. Mr LEE considered that HKMA should be more proactive in requiring AIs to expedite improvement in the internet security systems within a specific timeframe.

66. CE/HKMA advised that HKMA became aware of the problem of fake bank e-mails and websites in 2002. Since then, HKMA had alerted AIs to enhance their internet security systems for better management of the associated risks. HKMA had also set up a dedicated team to deal with e-banking matters, issued over 30 press releases to alert the public of the problem, and issued several circulars and guidelines to advise and remind AIs of the required measures and actions in dealing with the problem. CE/HKMA advised that a circular was issued in June 2004 recommending AIs to introduce two-factor authentication for high-risk retail internet banking transactions before mid-2005. He stressed that non-compliance with the circular and guidelines issued by HKMA could result in sanctions on AIs. Besides, the Code also stipulated the expected business standards and practices in respect of provision of internet banking service by AIs.

Automatic Teller Machine fraud

67. On Automatic Teller Machines (ATM) fraud cases, Mr Albert HO enquired about the progress of the actions taken by AIs to resolve the outstanding fraud cases discovered since 2003 and upgrade the technology of ATM for tackling the problem.

68. The Deputy Chief Executive (Acting) of the Hong Kong Monetary Authority (DCE(Atg)/HKMA) advised that HKMA had reminded AIs of the ways for handling customer complaints about ATM fraud and the importance of taking precautionary measures against the problem. No new ATM fraud cases had been reported since November 2003. As regards compensation for the affected customers, DCE(Atg)/HKMA said that the Code provided that if it was proven that there was no negligence on the part of customers, AIs should compensate for customers' loss. It was noted that the AIs concerned had taken a sympathetic attitude towards the affected customers and dealt with the cases in a reasonable manner. On efforts to tackle the problem, DCE(Atg)/HKMA advised that apart from stepping up consumer education in collaboration with the Police and AIs to promote customers' awareness of protecting their ATM cards and Personal Identification Numbers, HKMA had urged AIs to improve security measures in ATM systems. A number of AIs had already installed anti-fraud devices in ATMs and upgraded the technology to prevent counterfeit cards from accessing ATMs. CE/HKMA added that some AIs had also set up a mechanism to identify transactions made through counterfeit cards.

Commercial Credit Reference Agency Scheme

69. Mr Jeffrey LAM expressed the concern of small and medium-sized enterprises (SMEs) about how the CCRA Scheme could facilitate them in obtaining loans from banks. He also enquired whether HKMA would review the Scheme in due course.

70. In response, CE/HKMA advised that under the CCRA Scheme, credit information of SMEs would be collated and made available to AIs. It was believed that the Scheme would strengthen AIs' credit risk management, facilitate SMEs to obtain bank financing, and enable AIs to offer better terms to SME borrowers with

good credit records. He advised that over 30 000 SMEs had indicated that they would join the Scheme. The Scheme had just commenced on 1 November 2004. HKMA would closely monitor its operation and conduct a review in due course.

HKMA

VI. Briefing on the draft Citibank (Hong Kong) Limited (Merger) Bill

(LC Paper No. CB(1)103/04-05(05) — Information note (including the draft Bill) provided by Dr Hon David LI)

Briefing on the draft Bill

71. At the invitation of the Chairman, Dr David LI and Mr Atual MALIK, Country Business Manager, Hong Kong and Macau, Citibank N.A. briefed members on the draft Citibank (Hong Kong) Limited (Merger) Bill (the Bill). Dr LI pointed out that he would introduce the Bill into LegCo as a Member's Bill. The need for the Bill arose from the decision of the Citibank group to transfer the activities, assets and liabilities which constituted the retail banking business of Citibank N.A. (Citibank) located in Hong Kong, currently operated through a branch in Hong Kong, i.e. Citibank, Hong Kong Branch (Citibank(HKB)), to a wholly owned subsidiary of Citibank group of companies, i.e. Citibank (Hong Kong) Limited (Citibank(HKL)). He further pointed out that the increase in bank mergers in recent years was a reaction to the powerful market forces to transform the local banking industry. Dr LI took the opportunity to thank Members for their support for the previous bank merger bills, which had reinforced the international image of Hong Kong as an attractive centre for business and had helped to strengthen the local banking industry. Mr MALIK then highlighted the following points:

(a) The objective of the Bill was to transfer the activities, assets and liabilities which constituted the retail banking business of Citibank N.A. located in Hong Kong, currently operated through Citibank(HKB), to Citibank(HKL) which had been incorporated in Hong Kong and authorized under the Banking Ordinance (Cap. 155) as a restricted licence bank. Citibank(HKL)'s application for a full bank licence had just been approved by the Hong Kong Monetary Authority (HKMA);

(b) The Bill would enable Citibank to strengthen its ties and commitment to Hong Kong, and compete more effectively as a local bank in the local financial services sector;

(c) The proposed transfer by way of a Member's Bill would cause minimum impact on current customers, staff members and business partners of Citibank (HKB), and was the most efficient process for Citibank itself. The Bill was drafted on the basis of recently enacted merger ordinances; and

(d) There would be no leakage of taxation due to the Government arising from the proposed transfer and that Citibank(HKL) would continue to be taxed on the same basis as Citibank(HKB) at present. There would be no diminution of the scrutiny and accountability to which Citibank's Hong Kong retail banking operations were subject.

72. Upon the Chairman's invitation, the Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) (PAS/FST(FS)) advised that it was the Government's policy to support consolidation of the banking sector which would be conducive to enhancing the efficiency of the sector and the stability of the banking system in Hong Kong. In line with this policy, the Administration was in support of the Bill. The Head, Banking Supervision Division 1, HKMA (H(BSD)/HKMA) also confirmed that HKMA was in support of the Bill.

Discussion

Impact on customers

73. Noting that Citibank had been operating in Hong Kong for more than 100 years, Mr Albert CHENG was concerned why Citibank had decided to transfer its retail banking business in Hong Kong to Citibank(HKL). Given that Citibank was a reputable international bank incorporated in the United States (US) with substantial share capital, but Citibank(HKL), being its subsidiary incorporated in Hong Kong, had been set up with much less capital, Mr CHENG was concerned whether interests of Citibank's customers in Hong Kong would be adversely affected by the proposed transfer, in particular the transfer of liabilities. He also sought clarification on whether the proposed transfer was an indication of Citibank's lack of confidence in Hong Kong, and whether Citibank was seeking to limit its potential liabilities to the customers in Hong Kong by operating through a subsidiary incorporated in Hong Kong.

74. Mr Atual MALIK stressed that Citibank had full confidence in Hong Kong and the Bill demonstrated the bank's commitment to Hong Kong. He also pointed out that Citibank(HKL) would expand its retail banking business in Hong Kong by opening more branches and employing more staff. Ms Prudence HUANG, Chief Financial Officer, Hong Kong and Macau, Citibank N.A. advised that the Bill would provide more protection to local depositors of Citibank. She explained that Citibank(HKL) was required to meet the capital requirements specified by HKMA for locally incorporated banks, while Citibank(HKB), which was operating in Hong Kong as a branch of an overseas incorporated bank, was not required to maintain physical assets in Hong Kong. She further advised that after the proposed transfer, the capital of Citibank(HKL) would be increased to between US$700 million to US$1 billion.

75. On the concern about the capital level of Citibank(HKL), H(BSD)/HKMA advised that capital adequacy requirement was imposed by HKMA on locally

incorporated banks, including Citibank(HKL), to ensure that they maintained sufficient capital commensurate with the nature of their business and the risks they faced. However, Citibank(HKB) was not subject to the same requirement as it was not incorporated in Hong Kong. Nevertheless, it would be inappropriate to compare the capital level of Citibank(HKB) and Citibank(HKL) given the differences in their scale of operations and risk profiles.

76. Ms Mandy TAM asked whether Citibank's liabilities to its retail banking customers in Hong Kong would be limited to the capital level of Citibank(HKL) after the proposed transfer, and how customers' interests could be protected in the event that Citibank(HKL)'s assets were insufficient to meet customers' claims.

77. In response, Mr Simon BERRY, Partner, Allen & Overy explained that contractual rights of existing retail banking customers of Citibank(HKB) would remain substantially unchanged after the proposed transfer. As regards the concern about inability of Citibank(HKL) to meet customers' claims, although this would be a commercial matter for Citibank to comment on, Mr BERRY considered it unlikely that Citibank would allow its subsidiary to fall, as it would damage its business image.

78. Ms Emily LAU and Mr Albert HO were concerned about the impact of the proposed transfer on customers of Citibank in Hong Kong and enquired whether they had been consulted on the proposal. Mr Atual MALIK advised that Citibank had conducted opinion surveys of retail banking customers of Citibank(HKB) on the proposed transfer and the responses were positive. Responding to Mr HO's enquiry, Mr MALIK confirmed that there would be no option for existing customers of Citibank(HKB) to exclude themselves from the proposed transfer exercise.

79. Ms Emily LAU enquired how the Administration would ensure the protection of customers' interests in the transfer exercise. H(BSD)/HKMA advised that the Bill would enhance the protection for customers in two aspects. Firstly, Citibank(HKL) would be required to meet the capital adequacy ratio set by HKMA for locally incorporated banks. Secondly, it would be subject to a number of supervisory requirements that were applicable to locally incorporated banks, such as the requirement to comply with limits on large exposures and connected lending, and the requirement to establish a board of directors. PAS/FST(FS) stressed that the Administration was mindful of the need to ensure that interests of the affected customers would be properly safeguarded during the transfer process. She assured members that relevant Government departments and public bodies had been consulted on the draft Bill and they had indicated their support. Moreover, Citibank was required to submit a due diligence opinion on the proposed transfer. The Department of Justice had to be satisfied that all transfer of property and liabilities between the parties concerned were done in accordance with the laws of Hong Kong and that there would be no adverse impact on the property rights of the parties concerned. These were prerequisites for seeking the consent of the Chief Executive to introduce the Bill into LegCo.

80. Responding to Ms Emily LAU's further enquiry, PAS/FST(FS) confirmed that the Privacy Commissioner for Personal Data had been consulted on the draft Bill and was satisfied that the proposed transfer would be in compliance with the statutory data protection principles. Moreover, the Administration was not aware of any customers' complaints about protection of personal data arising from the bank merger ordinances enacted in the past.

Reasons for the proposed transfer

81. Mr Ronny TONG was not convinced by the responses given by Citibank and the Administration. He did not believe that local customers would receive less protection if Citibank continued to operate its retail banking business in Hong Kong through Citibank(HKB). He enquired about the real reasons for the proposed transfer of assets and liabilities to Citibank(HKL) and why the proposed transfer was regarded as a "merger". He considered it important for the Administration to seek such information from Citibank and to examine whether the reasons were compatible with Government policy.

82. In response, PAS/FST(FS) and H(BSD)/HKMA pointed out that bank mergers and reorganizations in Hong Kong were commercial decisions. The role of the Government was to ensure that these activities would not undermine the general stability and effective working of the banking system and the protection of depositors. PAS/FST(FS) further explained that as the transfer of assets and liabilities between merging entities by way of novation or assignment would incur higher costs, and in the absence of a generic legislation governing bank mergers and reorganizations in Hong Kong, such activities had been effected through Member's Bills. She assured members that the Administration would endeavour to ensure that the transfer of assets and liabilities between the merging entities would be done in accordance with the laws in Hong Kong and that the necessary requirements would be met.

Impact on staff

83. Ms Emily LAU expressed concern about the impact of the proposed transfer on staff of Citibank(HKB). She enquired whether the staff concerned had been consulted on the proposed transfer, and whether Citibank had any plans to lay off staff as a result of the transfer. Mr Atual MALIK responded that there had been no objection from the staff concerned on the reorganization proposal. All relevant staff of Citibank(HKB) had been employed by Citibank(HKL) on terms no less favourable than those which applied to them prior to the transfer. He re-iterated that Citibank(HKL) would continue to expand its business in Hong Kong and would employ more local staff.

Follow-up actions

84. Mr Ronny TONG suggested that Dr David LI, Citibank and the Administration be requested to provide a paper setting out clearly the reasons for the proposed transfer and whether the reasons were compatible with Government policy. Subject to the information provided in the paper, a bills committee might need to be formed to study the bill.

85. Ms Emily LAU said that while she had no objection to Dr David LI's proposal of introducing the Bill into LegCo, she considered that more information should be provided to facilitate Members' consideration of the Bill. Subject to the information provided, a bills committee might need to be formed to study the bill.

86. After discussion, the Chairman suggested and members agreed that Dr David LI, Citibank and the Administration be requested to provide a written response to address the major issues raised at the meeting, including those raised by Mr Ronny TONG.

> (*Post-meeting note:* At the suggestion of Ms Emily LAU after the meeting and with the concurrence of the Chairman, the Clerk invited Citibank to provide information on whether it had conducted similar transfer exercises for its retail banking business in other places; if it had, to provide details of the exercises; if it had not, to provide the reasons for conducting such a transfer exercise for the retail banking business in Hong Kong. The list of follow-up actions prepared by the LegCo Secretariat, and the written responses from Dr David LI and the Administration were circulated to members vide LC Paper No. CB(1)313/04-05 on 23 November 2004.)

VII. Any other business

87. There being no other business, the meeting ended at 1:20 pm.

Council Business Division 1
Legislative Council Secretariat
29 December 2004