立法會
Legislative Council

LC Paper No. CB(1)741/04-05
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by the Administration)

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Panel on Financial Affairs

Minutes of meeting
held on Monday, 6 December 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 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 CHIM Pui-chung Hon Albert Jinghan CHENG Hon TAM Heung-man
Members attending	:	Hon Mrs Selina CHOW LIANG Shuk-yee, GBS, JP Hon WONG Kwok-hing, MH Hon KWONG Chi-kin
Members absent	**:**	Hon LEE Cheuk-yan Hon WONG Ting-kwong, BBS

Public officers attending : Agenda Item III

Mr Henry TANG, GBS, JP
Financial Secretary

Mr KWOK Kwok-chuen, BBS, JP
Government Economist

Agenda Item IV

Mr William RYBACK
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Simon TOPPING
Executive Director (Banking Policy)
Hong Kong Monetary Authority

Mrs Clarie LO
Deputy Secretary for Financial Services and the Treasury (Financial Services)

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

Agenda Item V

Mr Kevin HO
Permanent Secretary for Financial Services and the Treasury (Financial Services)

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

Mr Norman CHAN
Deputy Chief Executive
Hong Kong Monetary Authority

Ms Effie YAO
Senior Manager (External)
Hong Kong Monetary Authority

Agenda Item VI

Miss Erica NG
Principal Assistant Secretary for Financial Services and the Treasury (Treasury) (Revenue Division)

Mr CHU Yam-yuen
Assistant Commissioner (Headquarters)
Inland Revenue Department

Mr Richard LEUNG
Chief Systems Manager (Inland Revenue)

Miss Shirley LEUNG
Departmental Secretary
Inland Revenue Department

Mr Victor LAM
Chief Systems Manager (Human Resources, Professional Development & Information Technology Management)
Office of the Government Chief Information Officer

Clerk in attendance : Miss Salumi CHAN
Chief Council Secretary (1)5

Staff in attendance : Ms Pauline NG
Assistant Secretary General 1

Ms May LEUNG
Legislative Assistant

<u>Agenda Items I to IV</u>

Ms Connie SZETO
Senior Council Secretary (1)4

<u>Agenda Items V and VI</u>

Ms Rosalind MA
Senior Council Secretary (1)8

Agenda Item IV

Mr KAU Kin-wah
Assistant Legal Adviser 6

Action

I. Information papers issued since the last meeting

Members noted the following information papers issued since the last regular meeting held on 1 November 2004:

(a) Consultation conclusions on the regulatory framework for addressing analyst conflicts of interest (LC Paper No. CB(1)172/04-05(01));

(b) Letter dated 1 November 2004 from the Federation of Hong Kong Industries, the Hong Kong General Chamber of Commerce, the Chinese General Chamber of Commerce, and the Chinese Manufacturers' Association of Hong Kong (with their joint submission on the Administration's consultation document on Estate Duty Review) (LC Paper No. CB(1)182/04-05(01));

(c) Securities and Futures Commission Quarterly Report for July to September 2004 (LC Paper No. CB(1)212/04-05);

(d) Mandatory Provident Fund Schemes Statistical Digest — September 2004 (LC Paper No. CB(1)312/04-05); and

(e) Second progress report on the Loan Guarantee Scheme for Severe Acute Respiratory Syndrome Impacted Industries (LC Paper No. CB(1)356/04-05(01).

II. Date of next meeting and items for discussion

(LC Paper No. CB(1)365/04-05(01) — List of outstanding items for discussion

LC Paper No. CB(1)365/04-05(02) — List of follow-up actions)

Special meeting on 17 December 2004

2. The Chairman reminded members that a special meeting had been scheduled for Friday, 17 December 2004, at 8:30 am to discuss the following items:

(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.

Regular meeting on 3 January 2005

3. The Chairman reminded members that the next regular meeting would be held on Monday, 3 January 2005, from 9:00 am to 12:30 pm to discuss the following items:

(a) Proposal of re-structuring the filing fees for non-Hong Kong companies; and

(b) Further discussion on proposed amendments to the Securities and Futures Ordinance — the proposal of splitting the post of the Chairman of Securities and Futures Commission into a non-executive chairman post and a chief executive officer post.

Special meeting on 19 January 2005

4. The Chairman reminded members that a special meeting had been scheduled for Wednesday, 19 January 2005, from 8:30 am to 9:30 am to receive a briefing by the Secretary for Financial Services and the Treasury on the relevant policy initiatives relating to financial affairs featuring in the Chief Executive’s Policy Address 2005.

Regular meeting in February 2005

5. Given the recent decision of the President that any unfinished business on the agenda for a Council meeting would be dealt with when the meeting resumed at 2:30 pm the following day (Thursday), members agreed that in order to avoid a possible clash with the Council meeting, the regular Panel meeting originally scheduled for Thursday, 3 February 2005 at 2:30 pm should be rescheduled to be held on Thursday, 17 February 2005 from 9:30 am to 12:30 pm.

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

(LC Paper No. CB(1)336/04-05 — Third Quarter Economic Report 2004 and the press release

LC Paper No. CB(1)365/04-05(03) — Paper provided by the Administration)

Briefing on the latest overall economic situation of Hong Kong

6. Upon invitation of the Chairman, the Government Economist (GE) briefed Members on the latest overall economic situation of Hong Kong, the updated economic forecasts by the Government for 2004 and outlook for 2005. GE highlighted the following points:

(a) The economic upturn of Hong Kong extended well into the third quarter of 2004, spurred by thriving merchandise exports and offshore trade, by continued growth in inbound tourism, and also by further solid growth in consumer and investment spending. The Gross Domestic Product (GDP) attained a notable growth at 7.2% in real terms in the third quarter of 2004 over a year earlier. Total exports of goods surged by 15.5% in real terms in the third quarter over a year earlier, while exports of services leaped by 10.3% in real terms with resilient growth in inbound tourism and continued robustness in offshore trade.

(b) In the domestic sector, local consumer spending held firm. Private consumption expenditure and overall investment spending attained a solid increase of 5.1% and 4.9% in real terms respectively in the third quarter of 2004 over a year earlier. But the slack construction output owing to the completion of a number of prominent private sector building projects and priority railway projects over the past year was still holding back the upturn in investment.

(c) In tandem with the economic upturn, labour conditions continued to improve. The seasonally adjusted unemployment rate fell from a peak of 8.6% in the second quarter of 2003 to 6.7% in August - October of 2004. The underemployment rate likewise fell over the same periods, from a peak of 4.3% to 3.2%. Overall labour earnings rebounded to a modest year-on-year increase in money terms in the second quarter of 2004 while earnings for the workers with low education attainment remained low.

(d) The property market regained momentum in recent months, with a strong rebound in trading activity in September 2004. The local stock market rallied strongly since late August 2004, responding to announcement of favourable corporate earnings results, release of upbeat GDP and Consumer Price Index (CPI) figures, as well as the announcement of additional liberalization measures under the second phase of Closer Economic Partnership Arrangement (CEPA II).

(e) Increase in consumer prices had arrested the 68-month long deflation in July 2004. The Composite CPI rose by an average of 0.8% in the third quarter of 2004 over a year earlier, reversing the 0.9% decline in the second quarter. It went up less in October, by just 0.2%.

(f) On updated short-term economic forecast for 2004, there were some encouraging developments in the external economic environment recently, including the easing in crude oil prices, the US interest rate hike proceeding at a measured pace and the world economy appearing to be better prepared for this interest rate up-cycle. In the Mainland, the cooling measures were effective in unwinding some of the imbalances in the economy. Moreover, the renewed weakness in the US dollar lately should enhance Hong Kong's external competitiveness and help to drive fund inflows into Hong Kong, leading to lower Hong Kong dollar interest rates. Locally, consumer and investment expenditure were poised for further growth amidst continuing economic upturn. Against this backdrop, GDP should be on track for a 7.5% growth in real terms for 2004 as a whole. Consumer prices were expected to stay positive in the rest of 2004. The Composite CPI was forecasted to have a modest decline of 0.3% for 2004 as a whole.

(g) As regards economic outlook for 2005, it hinged critically on the developments in the global economy, including sustainability of the solid growth momentum in the US economy, impact of the earlier oil price hikes on global economy, the extent of US dollar movements and its impact on global financial market stability, and the pace of interest rate hike, etc. The widely held view was that these risk factors might slow, but not severely retard, the growth momentum of the world economy next year. If so, it was believed that the Hong Kong economy would have another year of solid growth in 2005. The International Monetary Fund (IMF) lately forecasted that the Hong Kong economy would grow by around 4% in 2005.

Discussion

Economic recovery and inflation

7. Mr Andrew LEUNG enquired about the measures to be taken by the Administration to sustain the economic growth in Hong Kong. In response, FS stressed that the Government would continue to uphold the "Market leads, Government facilitates" principle in developing Hong Kong's economy. The

Government would keep up with its efforts to facilitate and enhance the competitiveness of the core industries of Hong Kong, including financial services, producer services, tourism and logistics. On Hong Kong's economic outlook for 2005, FS pointed out that as Hong Kong's economy was small and externally oriented, its economic performance would be influenced by the external environment. Important external risk factors affecting the growth of Hong Kong's economy included the trend of increase in crude oil prices, the weakening of the US dollar, the pace of interest rate hike in the US, and the economic growth in the Mainland and the outcome of its macroeconomic adjustment measures. Notwithstanding the aforementioned risk factors, the Administration was cautiously optimistic about the economic prospect of Hong Kong in 2005 which would be underpinned by a low interest rate environment and strong liquidity position in the banking sector.

8. Given the continued increase in import prices since the end of 2003, Mr Andrew LEUNG expressed concern about the return of inflation in Hong Kong. GE pointed out that the rise in import prices was due to the weakness in the US dollar and improved consumer spending brought about by the economic recovery. However, the pace of upturn in the CPI was being held back by the earlier fall-off in housing rentals. Responding to Mr LEUNG's enquiry on the Administration's forecast on consumer prices for 2005, GE said that while the rise in Composite CPI had been moderate since late 2003, the upward trend of inflation was expected to continue alongside with the positive outlook of the economy. Many economic analysts, including institutions such as the IMF, had forecasted that the Composite CPI would rise by 1% to 2% in 2005.

9. The Chairman expressed concern about the pressure on inflation in Hong Kong in the event of the appreciation of Renminbi (RMB) exchange rate. GE advised that as imports from the Mainland accounted for less than 10% of the total retained imports of Hong Kong, the impact on prices in Hong Kong as a result of appreciation of RMB would not be significant. However, the continued weakness in the US dollar would exert pressure on inflation in Hong Kong.

Implementation of CEPA

10. Mr CHAN Kam-lam enquired about the benefits brought about to Hong Kong by the implementation of CEPA, in particular to the manufacturing sector. He considered that the Administration should be more proactive in discussing with the Mainland authorities to expand the scope of CEPA, such as expanding the Individual Visit Scheme further to cover more Mainland cities. Mr WONG Kwok-hing enquired how the Administration would capitalize on the opportunities of CEPA to create employment in Hong Kong.

11. In response, FS said that CEPA was an unprecedented and on-going economic programme under which better terms were offered to Hong Kong enterprises than those of other World Trade Organization (WTO) members. The scope of liberalization under CEPA would be broadened and enriched through continuous

discussion with the Mainland authorities. Various plans and targets had been set for different phases of CEPA. These included strengthening and expanding the Individual Visit Scheme in the short term, extending the number of zero-tariff Hong Kong-made products in the medium term, and facilitating the services industry in the long term. FS emphasized that the implementation of CEPA I since 1 January 2004 had contributed to the recovery of Hong Kong's economy, eased the unemployment problem, and benefited a number of sectors including manufacturing, tourism, and services industries. The Administration believed that the implementation of CEPA II from 1 January 2005 onwards, which would expand the list of zero-tariff Hong Kong-made products exported to the Mainland by 713 items, would further promote industrial investment in Hong Kong and progressively increase employment opportunities for local manufacturing workers.

12. With a view to attracting more enterprises to move their production lines from the Mainland to Hong Kong so as to benefit from CEPA, Mr Jeffrey LAM suggested that the Administration should put in place more facilitation measures, such as streamlining of the application procedures for factory licences and removal of restrictions to facilitate the establishment of production lines in Hong Kong. Pointing out that there was a shortage in supply of skilled labour in the fashion and clothing industry, Mr LAM further suggested that the Administration should consider relaxing the criteria for importation of labour for the industry. Mr Albert CHENG did not support this suggestion because it would affect the interests of local manufacturing workers.

13. FS advised that with the implementation of CEPA, the Trade and Industry Department had set up a one-stop service centre to provide advice and assistance to enterprises for their operations in Hong Kong and the Mainland. The Administration welcomed views and suggestions from the business sectors on measures to improve its services in this area. If the business sectors encountered any difficulties or problems, they might approach the Administration so that proper follow-up actions could be taken and improvement measures could be devised in the light of the experience gained.

14. Mr CHIM Pui-chung pointed out that enterprises which planned to move their production lines back to Hong Kong for taking advantages of CEPA should be made aware of the fact that the operation costs in Hong Kong would be higher than those in the Mainland. In response, FS said that the 713 zero-tariff Hong Kong-made products to be covered by CEPA II were recommended by the business community after careful consideration of the competitive advantages and production costs. Furthermore, "Made in Hong Kong" products also commanded a premium because of their quality and reliability. FS believed that CEPA II would offer genuine benefits for enterprises to locate their production lines in Hong Kong.

Competition environment in business sector

15. Ms Emily LAU expressed concern that retail fuel prices had not fallen despite the reduction in international crude oil prices since late October 2004. She opined that there was an urgent need for the Administration to address the issue. FS noted the concern and pointed out that the Competition Policy Advisory Group (COMPAG) was looking into the matter. The Administration did not rule out the possibility of introducing legislation to regulate anti-competition acts in the fuel industry.

16. Mr Ronny TONG remarked that COMPAG, being a non-statutory body, would have difficulty in undertaking effective investigations into suspected anti-competition acts. He considered it necessary for the Government to set up a single statutory body to regulate anti-competition acts for all business sectors. The suggestion would address the present deficiencies in the regime and would be effective in handling cross-sectoral anti-competition acts. FS said that COMPAG had just started to look into the matter and had not encountered any difficulty so far. The Administration would consider the way forward after COMPAG had completed its investigations.

Admin

Addressing the unemployment problem

17. Ms Emily LAU expressed concern that the economic recovery of Hong Kong had not benefited the general public, in particular the less privileged class. She pointed out that a number of aged workers and workers with low education attainment still remained unemployed or were paid very low wages. Moreover, the problem of the widening gap between the rich and the poor had become more acute. Ms LAU expressed disappointment that the work of the Economic and Employment Council (EEC) had not been effective in tackling these problems. She called on the Administration to review the work of EEC and take concrete actions to address the problems. Mr Albert CHENG concurred that there was an urgent need for the Government to tackle problems of high unemployment rate and widening gap between the rich and the poor. He considered that it was the responsibility of the Government to enhance local employment and assist workers to find jobs.

18. In response, FS stressed that EEC had devised a number of measures to promote local employment. He also pointed out that in August – October 2004, total employment expanded by nearly 110 000 over the trough in mid 2003. In the same period, the seasonally adjusted unemployment rate also fell from the peak of 8.6% in the second quarter of 2003 to 6.7%. The improvement in employment situation had demonstrated the success of the "Market leads, Government facilitates" principle and the concerted efforts of EEC, the business and labour sectors. FS further pointed out that the recent economic upturn had encouraged more people to find jobs, thus resulting in a fast growth in the total labour force which outpaced the growth in total employment.

19. On the concern about low wages, GE explained that the phenomenon was inherent in the early stage of economic revival when companies were inclined to increase their investment in machinery and equipment instead of increasing

employment of workers. As a result, increase in labour earnings and wages often lagged behind economic revival. GE further pointed out that there was a recent upward trend in earnings and wages in the higher-skilled segment of the occupational hierarchy, such as managers and administrators, and it was envisaged that the trend would extend to the lower segment in due course with continuous robust economic growth.

20. Mr KWONG Chi-kin expressed support for the Administration to strengthen efforts in promoting tourism so as to help address the unemployment problem of the workers with low education attainment or low level of skills. In this connection, Mr Ronny TONG considered that there was room for Hong Kong to further develop tourism industry and international conference business. He suggested that the Administration should identify suitable places for the development of hotel resort areas, such as the Southern District and Sai Kung. FS undertook to consider Mr TONG's suggestion.

Admin

21. Pointing out that the printing of local stamps and bank notes was not done in Hong Kong, Mr Albert HO suggested that the Administration should explore the feasibility of enhancing the opportunity of local enterprises and service providers in bidding government contracts so as to create employment for local workers. FS explained that Hong Kong, as a member of WTO, was obliged to comply with the requirements of the WTO Agreement on Government Procurement (the Agreement) on contracts in respect of government purchase of goods and services. One of the requirements was to give the products, services and suppliers of any other Party to the Agreement treatment no less favourable than that given to the local products, services and suppliers. The purpose was to ensure that an equal opportunity was given to foreign suppliers and local suppliers in competing for government contracts.

22. Mr Albert HO opined that tender price should not be the only selection criteria for government contracts. Responding to Mr HO's enquiry, FS pointed out that the Agreement only applied to government contracts exceeding the specified threshold values. FS agreed to provide information on the threshold values for members' reference.

(*Post-meeting note:* The information was circulated to members vide LC Paper No. CB(1)757/04-05(02) on 20 January 2005.)

23. Mr SIN Chung-kai enquired about the Government's forecast on the unemployment rate for 2005. FS said that the unemployment situation would hinge on whether the economic growth in Hong Kong could be sustained. While the Government was cautiously optimistic about the economic outlook for Hong Kong, it recognized that the unemployment problem still posed a lot of challenges.

24. Mr WONG Kwok-hing expressed concern about the high unemployment rate in the construction sector and the lack of improvement in the manufacturing sector. He enquired about the measures taken by the Administration to tackle the problems.

FS re-iterated that it was the Government's role to facilitate the market while the private sector was the main provider of jobs. He stressed the importance for the Government, the business and labour sectors to make concerted efforts in resolving the unemployment problem. Regarding the development of the manufacturing sector in Hong Kong, FS considered that there was room for developing industries with high value-added and significant intellectual property contents. After the implementation of CEPA, there had been steady increase in investment in machinery and equipment in Hong Kong. Growth in expenditure on such items in the third quarter of 2004 was about 33% over a year earlier. The employment opportunities for local manufacturing workers had been increased accordingly.

25. As regards concern about the high unemployment rate in the construction sector, FS advised that the Government would continue to invest an average of around $29 billion a year on capital works projects for the period up to 2008-09. He pointed out that as compared with infrastructural projects by the public sector, building projects by the private sector were more labour intensive and involved less imported prefabricated components. Expansion in building activities by the private sector was essential in resolving the unemployment problem in the construction sector. FS envisaged that the economic upturn would contribute to further revival of the property market and would therefore help alleviate the unemployment problem in the construction sector in the long run.

26. Mr SIN Chung-kai noted that the Administration had awarded majority of the contracts under the Shenzhen Western Corridor to foreign enterprises. With a number of large-scale infrastructural projects in the pipeline, such as Hong Kong-Zhuhai-Macau Bridge, cross-border railway network, and development of Lantau Island, Mr SIN urged that the Administration should capitalize on these projects to create employment opportunities for local construction workers.

27. FS believed that the large-scale infrastructural projects would create a number of employment opportunities for local construction workers. He also pointed out that the development of Lantau Island would be a key economic development project for Hong Kong in future. The Administration would strive to strike a proper balance among three principles in taking forward the project, namely, economic viability of the project, conservation of the natural environment, and public participation in the project. The Administration had drawn up a concept plan for developing the project and would conduct consultation on specific programmes at a later stage.

28. Mr James TIEN said that the Liberal Party had suggested that the Administration should explore the idea of allowing the opening of a small casino on the Lantau Island so as to help resolve the unemployment problem of the workers with low education attainment or low level of skills. While recognizing that the Liberty Party's idea was innovative, FS pointed out that as gambling policy was a controversial issue and the community had divergent views on the opening of a casino in Hong Kong, it was necessary for the Administration to adopt a prudent approach in examining any proposal.

29. Mr James TIEN enquired whether the Administration would assess the number of job opportunities to be created by the Liberty Party's proposal. In response, FS advised that the Administration would normally undertake preliminary internal study on the possible benefits of proposals put forward to the Administration. Responding to Mr TIEN's further enquiry, FS said that should the Government ever decide that the proposal be pursued, it would provide relevant information to facilitate public discussion of the subject.

30. Mr Abraham SHEK did not support the Liberal Party's proposal of opening a small casino on Lantau Island, as the proposal would have impact on Hong Kong and Macau. He enquired whether the Government would consult the Central People's Government in this regard. In response, FS said that as provided in the Basic Law, the Hong Kong Special Administration Region should enjoy a high degree of autonomy and should, conduct the administrative affairs of the Region in accordance with the relevant provisions of the Basic Law.

31. Mr WONG Kwok-hing expressed concern that the importation of prefabricated building components had undermined the employment opportunities of local construction workers. Mr SIN Chung-kai opined that there was room for Hong Kong to develop the production of prefabricated building components. Pointing out that the Housing Authority had launched a trial scheme involving the production of prefabricated building components in situ in a construction site in Kwai Chung, Mr SIN urged that the Administration should identify suitable sites in industrial estates for the development of such production activity in Hong Kong.

32. As a measure to ease the unemployment problem in the construction sector, Mr Albert CHENG urged that the Administration should consider stipulating in tender contracts of public works projects the requirements for contractors to use locally produced prefabricated building components in the projects. Mr KWONG Chi-kin considered that the proposal of using locally produced prefabricated building components for public works projects merited consideration. However, Mr James TIEN stated that the Liberal Party did not support the proposal because of the higher costs involved.

33. On the suggestion of developing the production of prefabricated building components in Hong Kong, FS pointed out that the Construction Industry Council had examined the subject in detail and concluded that due to site constraints and adverse impact on the surrounding environment, it might not be advisable to pursue the suggestion. FS remarked that the Administration would consider application for land in industrial estates for such production activity and would consider using locally produced prefabricated components in public works projects on a case-by-case basis, taking into account its cost-effectiveness. In order to illustrate the impact on costs, FS undertook that the Administration would, when seeking funding approval from the Finance Committee and its Public Works Subcommittee on public works projects in future, select one or two projects and provide information comparing the costs

involved for the making of prefabricated building components in Hong Kong and other places, such as the Mainland.

(*Post-meeting note:* According to Financial Secretary's Office's reply dated 11 January 2005, the Office has requested the Environment, Transport and Works Bureau to take follow-up action.)

34. While expressing support for the Government to uphold the "Market leads, Government facilitates" principle and to continue investing in capital works projects, Mr Abraham SHEK was concerned that these measures were ineffective in resolving the unemployment problem in the construction sector. He called on FS to consider leading a committee to co-ordinate efforts from the Government, the construction industry and business community to promote the Private-sector Participation Initiative (PPI) model in Hong Kong. In response, FS said that PPI model had proven to be successful in implementing a number of projects in the public sector. It was the Government's policy to implement the model where appropriate.

35. With a view to expediting the commencement of construction projects, Mr Abraham SHEK called on the Administration to review the existing procedures in order to streamline the application process. FS advised that EEC had set up a subcommittee to look into the matter and recommend improvement measures. Mr SHEK urged that FS should closely monitor the work of the subcommittee.

36. Mr WONG Kwok-hing expressed concern about the slow progress in implementing the outstanding capital works projects of the former Provisional Urban Council and Provisional Regional Council. Mr WONG requested the Administration to expedite implementation of the outstanding projects in order to enhance employment in the construction sector. In this connection, he requested the Administration to provide a progress report on the subject to the relevant LegCo Panel. FS advised that the Home Affairs Bureau (HAB) was conducting a review on the projects. He undertook to convey Mr WONG's concern and request to HAB.

(*Post-meeting note:* According to Financial Secretary's Office's reply dated 11 January 2005, the Office has conveyed Mr WONG's views and request to HAB.)

IV. Briefing on the draft Banking (Amendment) Bill 2005

(LC Paper No. CB(1)365/04-05(04) — Paper provided by the Administration

LC Paper No. CB(1)365/04-05(05) — Background brief on the proposed implementation of the New Basel Capital Accord in Hong Kong prepared by the Legislative Council Secretariat)

Briefing by the Administration

37. At the Chairman's invitation, the Deputy Secretary for Financial Services and the Treasury (Financial Services) gave a brief introduction. She pointed out that the Administration had briefed the Panel in July 2004 on the broad concept of the New Basel Capital Accord (i.e. Basel II) and the Hong Kong Monetary Authority (HKMA)'s plan to implement the new capital regime on authorized institutions (AIs) in Hong Kong. In August 2004, HKMA issued a detailed consultation package on the subject to the banking industry and the public. The consultative proposals covered, inter alia, technical requirements on key areas of Basel II, the rule-making approach HKMA proposed to adopt in putting the revised capital framework into legislation, and the need for extending the current capital adequacy regime to the holding companies of AIs. The consultation period ended on 31 October 2004 and positive comments were received from the consulted parties. The Administration was preparing the draft Banking (Amendment) Bill (the Bill) for implementing the Basel II regime, which was expected to be available for industry consultation by early December 2004. Subject to any further comments of the industry and approval of the Chief Executive in Council, the Bill would be introduced into LegCo in the second quarter of 2005.

38. Upon invitation by the Chairman, the Deputy Chief Executive of the Hong Kong Monetary Authority (DCE/HKMA) gave a power-point presentation on the main concepts of Basel II and the progress of preparing the implementation of Basel II in Hong Kong. DCE/HKMA highlighted the following points:

(a) The international standards in banking supervision were set by the Basel Committee on Banking Supervision (BCBS). A key element of the BCBS' supervisory approach was the capital adequacy ratio (CAR) set out in the Basel Capital Accord adopted in 1988 (widely known as Basel I). Under Basel I, a capital adequacy measure was introduced for credit risk based on varying risk weights assigned to different classes of banks' assets.

(b) Hong Kong had adopted Basel I and its subsequent amendments through legislation under the Third Schedule to the Banking Ordinance

(BO) (Cap. 155). Despite the statutory minimum of 8%, the average CAR of all locally incorporated AIs was much higher, at 15% - 16%.

(c) Recent technological advancement, innovations in financial products, and further globalization had rendered Basel I too broad-brush and insufficiently "risk-sensitive" to capture many risks that banks faced, e.g. operational risk and interest rate risk in the banking book. The framework did not provide adequate incentives for banks to apply risk mitigation techniques. Against this backdrop, the BCBS published Basel II in end of June 2004 to replace Basel I.

(d) Basel II had a 3-pillar structure:
- Pillar 1 was essentially an upgrade of Basel I CAR that captured credit and market risks, but extended to operational risk;
- Pillar 2 focused on the supervisory review process of banks and required banks to have in place sound internal processes to assess their capital adequacy against risks including reputational risk and interest rate risk in the banking book which were not covered in Pillar 1; and
- Pillar 3 covered market discipline through public disclosure of bank's key information on capital, risk exposures and risk assessment.

(e) Under Basel II, banks would have several options to measure their credit risk. Those banks which had sophisticated internal ratings models to quantify their credit risk would use these systems to calculate their capital requirement for credit risk by adopting the Internal Ratings-Based (IRB) Approach. There were two variants, the Foundation and Advanced Approach. Other banks would use the Standardized Approach, which was similar to the current system, but with the important difference that the risk weights would be linked to external ratings and various risk mitigation techniques. Similarly, methods of varying sophistication would be available in respect of operational risk. Available approaches included the Basic Indicator, Standardized and Advanced Measurement Approaches.

(f) BCBS had proposed implementation of the Standardized and Foundation IRB Approaches from the end of 2006, and the most advanced approaches for credit risk and operational risk from the end of 2007. The Administration proposed to implement Basel II in Hong Kong by the end of 2006 to tie in with the BCBS timetable. A new Basic Approach, which was essentially a modified version of Basel I with slight definitional changes and incorporation of an operational risk capital charge and Pillars 2 and 3 under Basel II, would be made available to AIs with small, simple and straightforward operations to address industry concerns about costs and complexity of implementation. The choice of approaches was left to individual AIs, subject to the Monetary Authority (MA) being satisfied that AIs' choices were appropriate given the nature and scale of their activities.

(g) As Basel II involved a significantly more sophisticated approach to the calculation of CAR and extended its scope to bank holding companies (BHCs), it was necessary to amend the BO for implementing Basel II in Hong Kong. Proposed amendments to the BO involved three major areas, namely CAR of AIs, enhancement of the existing financial disclosure regime applicable to AIs, and imposition and policing of capital and disclosure requirements in respect of BHCs.

(h) It was proposed that the BO be amended to provide the MA with the power to promulgate Capital Rules and Disclosure Rules for the introduction of the revised capital framework. This was necessary given the impracticality of putting the complex requirements of Basel II into legislation through the existing approach and the ongoing need to keep the regime up to date in light of industry developments and evolving international practices. The power sought was strictly confined to making rules necessary for implementing Basel II. The Rules would have the status of subsidiary legislation, and hence would be subject to negative vetting by the Legislative Council (LegCo). The MA might issue guidelines to provide guidance on the exercise of his powers under the Rules.

(i) There were two other proposed amendments in the Bill, i.e. the amendments about vicarious liability of managers and publication of disciplinary action in respect of AIs' securities business.

(*Post-meeting note*: The power-point presentation material was issued to members vide LC Paper No. CB(1)421/04-05 on 7 December 2004.)

Discussion

Capital adequacy requirement on authorized institutions and bank holding companies

39. Mr CHAN Kam-lam noted that currently the MA was empowered to set the minimum CAR for individual banks in the range of 8% to 12%, and HKMA proposed that the upper end of the range should be extended to 16% (page 14 of the presentation material). Mr CHAN expressed concern about the need for the change and asked whether the existing ceiling of 12% was considered inadequate in addressing the risks faced by banks. He also enquired under what circumstances the MA would consider it necessary to raise the minimum CARs for individual banks. He stressed the importance for the MA to exercise his power in a fair and consistent

manner so as to ensure that the operating environment of the banking sector would not be adversely affected.

40. In response, DCE/HKMA explained that the MA was currently empowered to set the minimum CARs for individual licensed banks in the range of 8% to 12%, and for individual restricted licence banks and deposit-taking institutions in the range of 8% to 16%, based on HKMA's observation of their respective risks and assessment of their risk management systems. In practice, the minimum CARs for individual licensed banks were set in the range of 10% to 12%. Under special circumstances, such as the Asian financial crisis, the MA had required some AIs to raise the minimum CARs to reflect the risks they faced. DCE/HKMA said that while HKMA did not have the intention to raise the minimum CARs for individual AIs at the present stage, it was not sure whether such need would arise in future. For example, the rapid development of the global financial market might pose additional risks to banks' business. At present, the MA was able to require licensed banks to raise their minimum CARs above the 12% ceiling by mutual agreement. It was considered necessary to provide the MA with the statutory power to raise the minimum CARs to address risks in the banking industry should circumstances warranted.

41. Dr David LI pointed out that the implementation of Basel II in Hong Kong was a very complex exercise for the banking sector and required a lot of preparatory work. He expressed appreciation for HKMA's efforts in working out the details with the banking industry. In respect of the proposed legislative amendment for imposing the CAR requirement on BHCs (page 23 of the presentation material), Dr LI enquired about the reason for and details of the proposal.

42. DCE/HKMA explained that Basel II was designed to apply not only to individual banks but also to BHCs, i.e. the parent entities within banking groups, to ensure that the risk that the whole banking group posed to an AI was captured in the risk assessment process. The aim was to achieve consolidated supervision. It was proposed that the MA might designate any controller of an AI as a BHC. However, HKMA envisaged that the applicability of the provision would be very limited. A controller would not be designated if it was an AI incorporated in Hong Kong, or if it was incorporated outside Hong Kong and was subject to adequate supervision. Hence, it was expected that only a handful of controllers would be designated as BHCs in Hong Kong.

Timetable and cost for implementing Basel II

43. Given the substantial time and resources required of AIs to prepare for the implementation of Basel II in Hong Kong, such as those required for upgrading the internal systems and manpower training, the Chairman was concerned whether AIs would be able to meet the BCBS timetable of implementing the basic approaches by the end of 2006 and the most advanced approaches by the end of 2007.

44. DCE/HKMA said that HKMA recognized that implementation of Basel II would require substantial investment of AIs in time and resources. Hence, for the most advanced approaches, HKMA had not specified any particular time frame for AIs to adopt such approaches and had reminded them that they should consider setting their own implementation timetables realistically having regard to their own situations rather than complying with the deadlines set by the BCBS. In DCE/HKMA's view, it would be more appropriate for AIs aspiring to adopt the most advanced approaches to stretch the implementation timetable a bit further to the end of 2009.

45. As regards the costs for implementing Basel II by individual AIs, DCE/HKMA considered it difficult to estimate the costs involved. However, given that the substantial portion of the costs would be absorbed by AIs' on-going efforts for the improvement of their risk management systems, it was envisaged that AIs should have no difficulty in meeting the expenditure.

Other proposed amendments covered by the Bill

46. Mr SIN Chung-kai indicated that the Democratic Party was supportive of the implementation of Basel II in Hong Kong so as to keep in pace with international developments. Mr SIN noted that the proposed amendments included a proposal to amend sections 58A and 71C of the BO to put it beyond doubt that the MA might publish his disciplinary actions against relevant individuals and executive officers of AIs in a manner followed by the Securities and Futures Commission (SFC) (page 29 of the presentation material). While expressing support for the proposal, Mr SIN enquired about the reasons for including in the Bill such a proposal which was not related to the implementation of Basel II in Hong Kong. Mr CHIM Pui-chung also enquired whether the proposal implied that there was a discrepancy between the regulatory standards adopted by HKMA on AIs' securities business and by SFC on its licensees.

47. DCE/HKMA advised that the proposed amendments were introduced for improving the working of certain provisions of the BO in the light of experience. He explained that under the Securities and Futures Ordinance (Cap. 571), SFC might publish its disciplinary actions on its licensees. In doing so, SFC also disclosed the relevant facts and findings surrounding the cases. Although HKMA was given similar powers under sections 58A and 71C of the BO, there was doubt as to whether

the MA could publish his disciplinary actions in view of the confidentiality obligations imposed on him by section 120 of the BO. As such, there could be differences between the ability of SFC and HKMA to disclose their disciplinary decisions on SFC licensees and AIs in respect of misconduct in the operation of securities business. It was therefore necessary to provide expressly in the BO for the MA to have the same powers as SFC in this regard. DCE/HKMA agreed with Mr CHIM Pui-chung's view that it was necessary for the two regulators to adopt the same regulatory standards. To such end, HKMA and SFC had been maintaining close liaison and holding discussions regularly on the subject to address issues of mutual concern.

V. Proposal for contribution to the 8th replenishment of the Asian Development Fund

(File Ref: A2/5C(2004) — Legislative Council Brief on "Asian Development Bank - Hong Kong's Contribution to the 8th Replenishment of the Asian Development Fund" issued by Financial Services and the Treasury Bureau

LC Paper No. CB(1)365/04-05(06) — Background brief prepared by the Legislative Council Secretariat)

Briefing by the Administration

48. At the invitation of the Chairman, the Deputy Chief Executive, Hong Kong Monetary Authority (DCE/HKMA) briefed members on the proposal for Hong Kong to contribute US$19.19 million to the 8^{th} replenishment of the Asian Development Fund (ADF IX) of the Asian Development Bank (ADB) over a ten-year period. He pointed out that ADF, established in 1973, was a concessional lending window of ADB available to the most needy members in the Asia and Pacific region to support poverty reduction and improve the quality of life. Hong Kong had been a donor of ADF since 1983 (ADF IV). Unlike the token donations in ADF IV to VI, Hong Kong had made contributions according to the consensus burden sharing formula since ADF VII in 1997. The burden sharing formula was based on a donor member's per capita Gross National Product (GNP) and adjusted for its shareholding in ADB. According to the formula, Hong Kong's burden sharing ratio was 0.57% of the target size of contributions by donors, which translated into US$19.19 million for Hong Kong's contribution to ADF IX. DCE/HKMA highlighted the reasons for the proposal, as follows:

(a) ADB was one of the few multilateral financial institutions in which Hong Kong was a full member. As a responsible member, Hong Kong had the obligation to support ADB activities as fully as possible;

(b) Hong Kong had benefited from ADB operations in the region. In the period from 1972 to 1980, Hong Kong obtained five loans from ADB to finance the construction of public housing projects, sewage, polyclinic and other infrastructure project;

(c) ADB had contributed to the development of the bond market in Hong Kong by being an active bond issuer for both foreign currency and Hong Kong dollar bonds. In particular, ADB was the first international financial institution which had issued bonds straddling 1997, demonstrating its confidence in Hong Kong for a smooth transition and conveyed the "business as usual" message in the run up to 1997; and

(d) Hong Kong derived indirect economic benefits from the contribution, as firms in Hong Kong were able to bid for ADB projects. According to ADB, on a cumulative basis up to the end of 2003, Hong Kong firms had been awarded a total of US$589 million worth of goods and civil works procurement contracts and US$46 million worth of consulting services and technical assistance contracts in relation to all ADB sponsored projects.

Discussion

49. Mr Albert CHENG expressed support for the proposal for Hong Kong to contribute to ADF IX according to the consensus burden sharing formula. He agreed that as a responsible member, Hong Kong had the obligation to support ADB activities. Pointing out that "it is more blessed to give than to receive", Mr CHENG considered that Hong Kong should contribute to ADF for poverty reduction in the Asia and Pacific region.

50. Mr SIN Chung-kai said that Members of the Democratic Party supported the proposal as it was Hong Kong's international obligation to contribute to ADF.

51. Mr CHAN Kam-lam said that Members of the Democratic Alliance for Betterment of Hong Kong supported the proposal and considered that Hong Kong had the international obligation to support ADB activities for poverty reduction and improving the quality of life in the Asia and Pacific Region.

52. Mr Abraham SHEK said that Members of the Alliance supported the proposal. He suggested that the Administration should explore with ADB the measures to facilitate the participation of Hong Kong firms and professionals in ADB sponsored projects so that they could stand a fair chance in bidding for these projects.

53. The Permanent Secretary for Financial Services and the Treasury (Financial Services) (PSFS) thanked members for their support. He informed members that the

Administration planned to submit the proposal to the Finance Committee (FC) for consideration at its meeting scheduled for 17 December 2004.

(*Post-meeting note:* The Administration's response to Mr Abraham SHEK's suggestion at paragraph 52 above was circulated to members vide LC Paper No. CB(1)815/04-05(01) on 28 January 2005.)

VI. Proposed creation and deletion of one permanent Chief Systems Manager post

(LC Paper No. CB(1)365/04-05(07) — Paper provided by the Administration)

Briefing by the Administration

54. At the invitation of the Chairman, the Assistant Commissioner (Headquarters), Inland Revenue Department (AC/IRD) briefed members on the proposal to permanently redeploy a Chief Systems Manager (CSM) post (D1) from the Office of the Government Chief Information Officer (OGCIO) to IRD with effect from 1 April 2005. He pointed out that it was a cost-neutral transfer involving the creation of a permanent CSM post in IRD to be offset by the deletion of a permanent CSM post in OGCIO on the same date. The CSM post had been assigned for dedicated and professional support to IRD's information technology (IT) projects for over four years and was not included in OGCIO's organization structure when the latter was established in July 2004. The present proposal would regularize the establishment structures of IRD and OGCIO. AC/IRD also pointed out that the proposed CSM post to be created in IRD's establishment would provide support to the senior management in the following aspects:

(a) Information systems strategic planning and implementation;

(b) IT management;

(c) IT security; and

(d) Management of the Information Technology Management Unit and IT staff.

Discussion

55. Mr CHAN Kam-lam said that he had no objection to the proposal in principle as it was a cost-neutral proposal. Noting from the proposed organization chart of IRD at Enclosure 3 to the paper that a team of over 80 supporting staff (including staff of the Computer Operator Grade and Data Processor Grade) would be under the supervision of the proposed CSM post, Mr CHAN was concerned whether the

supporting staff were newly recruited for the proposed post and if so, the staff cost involved. In response, AC/IRD advised that the supporting staff concerned were existing staff under the supervision of the Senior Assessor (Computer)1 in IRD. They would be redeployed to support the CSM after the proposed post was created. AC/IRD confirmed that the proposal would not involve any additional staff cost. In response to Mr CHAN's further enquiry, AC/IRD advised that the proposed creation of the CSM post was not related to the work of the proposed Goods and Services Tax under study.

56. Mr SIN Chung-kai expressed support for the proposal. He also considered that the Administration should further strengthen the use of IT in the work of IRD.

57. There being no other questions from members, the Chairman concluded that the Panel supported the proposal in principle. Members noted that the Administration planned to submit the proposal to the Establishment Subcommittee for consideration at its meeting scheduled for 19 January 2005.

VII. Any other business

Date for submitting the proposal under Agenda Item V to the Finance Committee

58. Referring to the remarks made by PSFS towards the end of the discussion of Agenda Item V, the Clerk advised members that if the proposal for Hong Kong's contribution to the 8th replenishment of ADF was to be submitted to FC for consideration at its meeting on 17 December, the Administration was required to provide the relevant paper for issue to FC members on or before 10 December. The Administration would consider whether it would be able to meet the deadline for provision of paper for the FC meeting on 17 December; if not, it would submit the proposal to FC for consideration at its meeting in January 2005.

> (*Post-meeting note*: The Administration submitted the proposal to FC for consideration at its meeting on 17 December 2004.)

59. There being no other business, the meeting ended at 12:10 pm.

Council Business Division 1
Legislative Council Secretariat
8 February 2005