立法會
Legislative Council

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(These minutes have been seen
by the Administration)

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Panel on Financial Affairs

Minutes of meeting
held on Monday, 6 February 2006 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)
Ir Dr Hon Raymond HO Chung-tai, S.B.St.J., JP
Hon LEE Cheuk-yan
Dr Hon David LI Kwok-po, GBS, JP
Hon CHAN Kam-lam, SBS, JP
Hon SIN Chung-kai, JP
Hon Emily LAU Wai-hing, JP
Hon Jeffrey LAM Kin-fung, SBS, JP
Hon Andrew LEUNG Kwan-yuen, SBS, JP
Hon WONG Ting-kwong, BBS
Hon CHIM Pui-chung
Hon TAM Heung-man

Members absent : Hon James TIEN Pei-chun, GBS, JP
Hon James TO Kun-sun
Hon Abraham SHEK Lai-him, JP
Hon Albert Jinghan CHENG

Public officers attending	:	Agenda Item IV Mr Joseph YAM, GBS, JP Chief Executive Hong Kong Monetary Authority Mr William RYBACK, JP Deputy Chief Executive Hong Kong Monetary Authority Mr Peter PANG, JP Deputy Chief Executive Hong Kong Monetary Authority Mr Y K CHOI, JP Deputy Chief Executive Hong Kong Monetary Authority Agenda Item V Mrs Sarah KWOK Deputy Secretary for Financial Services and the Treasury (Financial Services) Agenda Item VI Mr Albert LAM Deputy Secretary for Financial Services and the Treasury (Financial Services)2 Ms Cora HO Principal Assistant Secretary for Financial Services and the Treasury (Financial Services)3
Attendance by invitation	:	Agenda Item V Mrs Alexa LAM Executive Director, Intermediaries and Investment Products Securities and Futures Commission Mr Stephen PO Senior Director, Intermediaries and Investment Products Securities and Futures Commission

Agenda Item VI

Mr Darren McShane
Executive Director (Regulation and Policy)
Mandatory Provident Fund Schemes Authority

Ms Gabriella YEE
Senior Manager (Policy and Development)
Mandatory Provident Fund Schemes Authority

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

Staff in attendance : Mr KAU Kin-wah
Assistant Legal Adviser 6

Ms Connie SZETO
Senior Council Secretary (1)4

Ms Rosalind MA
Senior Council Secretary (1)8

Mr Justin TAM
Council Secretary (1)3

Ms May LEUNG
Legislative Assistant (1)8

Action

I. Confirmation of minutes of meeting
(LC Paper No. CB(1)805/05-06 — Minutes of meeting on 5 December 2005)

The minutes of the meeting held on 5 December 2005 were confirmed.

II. Information paper issued since the last meeting

2. Members noted that an information paper on "Transfer of banking business in Hong Kong" (LC Paper No. CB(1)813/05-06(01)) had been issued since the last regular meeting held on 5 January 2006.

III. Date of next meeting and items for discussion

(LC Paper No. CB(1)806/05-06(01) — List of outstanding items for discussion

LC Paper No. CB(1)806/05-06(02) — List of follow-up actions)

3. The Chairman informed members that the following three items were proposed for discussion at the next regular meeting of the Panel to be held on Monday, 6 March 2006:

(a) The Securities and Futures Commission (SFC) Budget for the financial year 2006-07;

(b) Outcome of consultation on the new structure for listing decision-making — Composition changes to the Listing Committee; and

(c) Progress on the implementation of the Deposit Protection Scheme.

4. On paragraph 3(a) above, the Chairman pointed out that in line with the normal practice, SFC would present its annual budget to the Panel for information before seeking the approval of the Financial Secretary on the budget. On paragraph 3(b), at the invitation of the Chairman and Deputy Chairman, the Administration, SFC and the Hong Kong Exchanges and Clearing Limited would brief the Panel on the outcome of the consultation on the new structure for listing decision-making and the related Listing Rules amendments. As regards paragraph 3(c), the Administration would report to the Panel on the progress made by the Deposit Protection Board on the implementation of the Deposit Protection Scheme.

5. Members agreed that the three items mentioned in paragraph 3(a) to (c) above be placed on the agenda for the meeting on 6 March 2006. They also agreed that the meeting be held from 10:00 am to 12:30 pm.

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

(LC Paper No. CB(1)806/05-06(03)	—	Paper provided by the Hong Kong Monetary Authority
LC Paper No. CB(1)806/05-06(04)	—	Letter dated 13 December 2005 from the Clerk to Panel to the Chief Executive of the Hong Kong Monetary Authority (CE/HKMA) on "Closure of local branches by banks"
LC Paper No. CB(1)806/05-06(05)	—	Letter dated 15 December 2005 from the Clerk to Panel to CE/HKMA on "Policy and arrangement governing post-termination employment of HKMA's senior staff" (with an information paper provided by the Administration to the Panel on Public Service on "Arrangements governing the taking up of outside work by directorate civil servants after ceasing active government service")
LC Paper No. CB(1)806/05-06(06)	—	Letter dated 5 January 2006 from the Clerk to Panel to CE/HKMA about HKMA's annual budget
LC Paper No. CB(1)806/05-06(07)	—	Reply dated 27 January 2006 from CE/HKMA responding to the issues set out in LC Paper Nos. CB(1)806/05-06(04), (05) and (06)
LC Paper No. CB(1)806/05-06(08)	—	LegCo Question No. 5 raised by Hon KWONG Chi-kin on "Former senior staff of statutory regulators taking up outside work" at the Council meeting on 14 December 2005
LC Paper No. CB(1)806/05-06(09)	—	Extract of Hansard of the Council meeting on 14 December 2005

LC Paper No. CB(1)1312/04-05(03) — Letter dated 19 April 2005 from the CE/HKMA to the Chairman of the Panel

LC Paper No. CB(1)1312/04-05(05) — Requests previously raised by members of the Panel for information about HKMA's annual budget)

Briefing by the Hong Kong Monetary Authority

6. 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 exchange rate had strengthened steadily against the United States (US) dollar since June 2005, reaching levels close to the strong-side Convertibility Undertaking of 7.75. Since June 2005, the Convertibility Undertakings had not been triggered, and HKMA had not conducted any monetary operations within the Convertibility Zone. The Aggregate Balance remained stable at around HK$1.3 billion. The three refinements to the Linked Exchange Rate (LER) System introduced in May 2005 had been effective in keeping the Aggregate Balance and money market conditions generally stable. The discount in the one-year forward exchange rate narrowed markedly in the second half of 2005, but started to widen again towards the year-end to around 400 pips.

(b) On the external factors affecting currency stability, high oil prices remained a key factor. Further increase in oil prices might lead to higher inflation and monetary tightening. Other external factors included US current account deficit, US dollar interest rate and renminbi (RMB) exchange rate. The US current account deficit had continued to grow in recent years, reaching 6.2% of Gross Domestic Product (GDP) in the third quarter of 2005. Nevertheless, the widening of interest rate differentials in favour of the US gave support to the US dollar and attracted capital flows into the US to finance its large current account deficit. The US federal funds target rate (FFTR) had been raised 14 times to 4.50% since June 2004. This had led to increases in the lending rates and deposit rates of banks in Hong Kong. While the market expected that the FFTR would reach the peak in the first half of 2006, CE/HKMA considered it more likely that the rising trend might slow down and the rate would remain stable for a while. As regards RMB exchange rate, it had remained strong with speculations about RMB appreciation intensifying towards the later part of 2005. On market speculations about the appreciation of Hong Kong dollar alongside with

RMB, it should be noted that the Government was committed to the maintenance of the LER system and HKMA had adequate measures to maintain a stable Hong Kong dollar exchange rate. Given the present exchange regime of RMB, it was technically not feasible for any linkage between the exchange rates of Hong Kong dollar and RMB. Nevertheless, the gradual appreciation of RMB would be beneficial to the economic development and integration of Hong Kong and the Mainland.

(c) On the domestic factors affecting currency stability, Hong Kong's economic growth was expected to continue in 2006. On a seasonally adjusted quarter-on-quarter basis, GDP grew by 2.7% in real terms in the third quarter of 2005, following an increase of 3.4% in the second quarter. While the Composite Consumer Price Index edged up steadily in recent months, the risk of a sharp increase in inflation remained low. The current account surplus increased markedly in the first three quarters of 2005 from the same period of 2004. The investment income generated by the accumulated net foreign assets would continue to support the Hong Kong dollar, inserting pressure for its appreciation. Residential property prices had increased on average by 49% from the trough in the summer of 2003 despite some moderation in recent months. Alongside the economic recovery, the Government's fiscal position had improved since the fourth quarter of 2003. There were two consecutive quarters of net placements with the Exchange Fund (EF) in the fourth quarter of 2004 and the first quarter of 2005, followed by net draw-downs in the second and third quarters of 2005. The balance returned to a surplus again in the fourth quarter of 2005.

(d) On banking sector performance, the banking sector remained well-capitalized. However, as the increase in the cost-to-income ratio indicated, rising operating costs had begun to put pressure on profitability. Net interest margin of retail banks increased to 1.68% in 2005 from 1.66% in 2004 but remained low by historical standards. The low net interest margin reflected intense competition in the banking sector. Increased competition had obliged banks to pay greater attention to their costs and this, together with the introduction of new technology, had led to some consolidation of bank branches. To address the concern of the public about the provision of banking services, the Hong Kong Association of Banks (HKAB) was going to establish a working group to look into ways to alleviate the effects of branch closure and facilitate access to services with a view to identifying a solution acceptable to the parties concerned. Total domestic lending increased by 3.9% in the fourth quarter of 2005 after a slight decrease of 0.8% in the third quarter of 2005. The quality of banks' consumer portfolio improved, as demonstrated by the declining trend in credit card charge-off and delinquencies. The number of residential mortgage loans in negative

equity had increased from 9 000 cases to around 11 000 cases from September to December 2005 with an aggregate value of HK$19 billion. Nevertheless, this did not necessarily mean a corresponding deterioration in the quality of mortgage loans of banks. Banks were still adhering to the 70% loan-to-value-ratio rule. The additional top-up portion of the mortgage loans were covered by mortgage insurance.

(e) On the progress of the implementation of Basel II in Hong Kong, HKMA had released five packages of proposals for consultation. HKMA aimed to implement the proposals on the revised capital standards by bringing into effect the provisions relating to the consultation on the Capital and Disclosure Rules, which were subsidiary legislation, and the establishment of a Capital Adequacy Review Tribunal in 2006. As regards prevention of money laundering, following the introduction of the self-assessment framework in June 2005, initial review showed that authorized institutions were generally in compliance with the relevant requirements. On the other hand, preparation for the launch of the Deposit Protection Scheme was in good progress and it was expected that the Scheme would start collecting contributions in the second half of 2006. As to positive data sharing, clear benefits had emerged, i.e. decline in the average relative amount of bankruptcy indebtedness and shift of credit card rollover balances to cheaper non-card credits.

(f) On market infrastructure, efforts were devoted to building Hong Kong's financial infrastructure on a multi-currency platform to facilitate domestic and international financial intermediation, with clearing and settlements completed in a safe and efficient manner. Implementation of the recommendations arising from the review of financial infrastructure development was in good progress. However, in taking forward the development of financial infrastructure to meet the challenges of advancement in technology and global trends, the "deep-rooted dilemma" in striking a balance between the public and sectoral interests in the financial field had to be resolved.

(g) As regards the reinforcement of the position of Hong Kong as an international financial centre, implementation of the Asian Bond Fund 2 had been making good progress, with considerable growth in asset size of the two components funds listed in Hong Kong. Moreover, a number of measures had been implemented in December 2005 for expansion of RMB business in Hong Kong. In addition to the introduction of RMB cheques in March 2006, HKMA would continue to discuss with Mainland authorities on using RMB to settle cross-border trade and issuing RMB bonds in Hong Kong.

(h) Regarding the performance of EF, the investment outlook of EF was full of challenges given the volatility of the financial markets. The Treasury's share of the EF investment income fluctuated from year to year, ranging from a low of HK$1.6 billion in 2001 to a high of HK$45.4 billion in 1999. It was worth noting that the investment strategy of EF was different from other investment funds, and was determined by the objectives of capital preservation, liquidity, full backing of the Hong Kong-dollar Monetary Base and maintaining the long-term purchasing power of the assets. The investment return of EF should be weighted against the investment benchmark determined by the Exchange Fund Advisory Committee (EFAC).

(*Post-meeting note:* Updated version of the power-point presentation material was issued to members and non-Panel Members vide LC Paper No. CB(1)806/05-06(03) on 7 February 2006.)

Discussion

US interest rates

7. Mr Andrew LEUNG sought the view of CE/HKMA on whether the recent change in the chairmanship of the US Federal Reserve Board, with Dr Ben BERNANKE taking up the post from Dr Alan GREENSPAN, would have any significant impact on the US interest rates.

8. In reply, CE/HKMA said that the stance of the Federal Reserve Board on the interest rate level under the leadership of the new Chairman was a subject of concern in the global market. Given the new Chairman's concern about inflation in the US, there might be monetary tightening and a lower possibility for US interest rates to reach the peak. CE/HKMA was of the view that the US interest rates might stabilize in 2006 rather than reaching the peak. Given the uncertainty of continuing external payment imbalance of the US and the volatility in the global financial markets, it was difficult to predict when the US interest rates would reach the peak. In this connection, market participants and investors should be mindful of the importance of risk management.

9. Mr Andrew LEUNG sought the view of CE/HKMA on the possible impacts of terrorist attacks on the US economy. In response, CE/HKMA said that he was not an expert in this field but it was understandable that in the event of a terrorist attack, there would be great impact on the US economy in terms of fluctuations in US dollar exchange rate, the bond market as well as the stock market.

Appreciation of RMB

10. Mr Jeffrey LAM was concerned whether further appreciation of RMB in 2006 would result in capital inflow to Hong Kong and affect the stability of the Hong Kong

dollar, thus causing inflation and rise in property prices. In this connection, Mr LAM sought CE/HKMA's view on whether any particular trade or industry would more likely be affected by the appreciation of RMB. Ir Dr Raymond HO also expressed concern about the impact of the appreciation of RMB.

11. CE/HKMA said that as in the case of the 18-month period prior to the introduction of the three refinements to the LER system in May 2005, expectations of an appreciation of RMB exchange rate and speculation that the Hong Kong dollar exchange rate might appreciate along with RMB had attracted capital inflow and caused the Hong Kong dollar interest rates to stay at a very low level, which might benefit borrowers by obtaining funds at lower costs. However, the introduction of the three refinements had provided HKMA with additional tools to manage the impact of capital inflow. In general, fluctuations in interest rates would not be conducive to the development of any trade or industry in the long run.

Economic growth and inflation

12. Noting the notable increase in current account surplus in 2005 and that the economic growth was expected to continue in 2006, Ir Dr Raymond HO enquired whether the Administration had any measures to maintain the competitiveness of Hong Kong in the global market. Referring to the various external factors affecting the currency stability of Hong Kong set out in the presentation material provided by HKMA, Ir Dr HO expressed particular concern about the impact of inflation on the economy of Hong Kong as well as the possibility of asset price bubbles.

13. CE/HKMA said that Hong Kong was maintaining its path of economic growth and its competitiveness in the global market. In his opinion, the best way for Hong Kong to keep up its competitiveness was to maintain the flexibility of its present system under which economic activities were driven by market forces. On the issue of inflation, CE/HKMA pointed out that inflation rate would be affected by a number of factors beyond control, such as the appreciation of RMB which would result in rise in prices of goods from the Mainland and capital inflow in speculation for appreciation of Hong Kong dollar alongside with RMB. While such capital inflow might result in lower interest rates and higher property prices, he hoped that the gradual appreciation of RMB in the recent months would reduce the extent of such impact. Responding to Ir Dr Raymond HO's further enquiry, CE/HKMA said that he did not consider the present trend of inflation worrying and in the event that the inflation rate reached a level which undermined the competitiveness of Hong Kong in the global market, the drop in external demand would automatically adjust the inflation rate.

Capital supply and credit provision in the banking sector

14. Noting that the average consolidated capital adequacy ratio (CAR) of banks was well above the statutory requirement and international standard of 8%, Mr Ronny TONG enquired about its implications on the Hong Kong economy. Mr TONG also enquired whether the abundance of capital supply in the banking sector would enable banks to provide funding support for large scale infrastructural projects.

15. CE/HKMA explained that CAR was the ratio of a bank's capital base to its risk-weighted credit exposures. A bank with the CAR above the required standard meant that the bank had adequate capital to meet additional demand for credit, including demand for credits for infrastructural projects. That said, CE/HKMA pointed out that in deciding whether an infrastructural project should be taken forward, the Administration took into consideration various factors in addition to the source of funding.

16. Referring to recent media reports on capital inflows from Middle East countries such as Iran, Mr Ronny TONG enquired about the impact of such capital inflows on the Hong Kong economy. CE/HKMA advised that there was no information on the origin of capital inflows in banks' regular return to HKMA. He pointed out that as an international financial centre, Hong Kong maintained a free economy and did not impose any restrictions on the inflow of capital from other countries nor employ any measures to restrict such inflow. Given the extent of US trade deficit and current account deficit, it was understandable for a country with reserves in foreign exchange to consider diversifying its investment for risk management purpose. CE/HKMA said that only capital inflow related to money laundering activities would be subject to control in line with the best international practices for the prevention of money laundering.

17. Mr CHIM Pui-chung enquired about the guidelines for banks to underwrite customer loans. CE/HKMA explained that it was the commercial decision of individual banks to offer loans to their customers. The role of HKMA in banking supervision was to ensure that banks would develop prudent policies and systems for managing the risks arising from high risk lending business.

Residential mortgage loans in negative equity

18. Noting that the number of residential mortgage loans in negative equity increased by about 2 000 cases in the fourth quarter of 2005, Mr Jeffrey LAM was concerned whether this would threaten the stability of the banking system. He also enquired whether the increase was in any way related to the provision of mortgage loans of up to 95% of the property value through the Mortgage Insurance Programme (MIP) administered by the Hong Kong Mortgage Corporation Limited (HKMC). Mr WONG Ting-kwong expressed similar concern and sought CE/HKMA's analysis

on the impact of the increase in the number of residential mortgage loans in negative equity on Hong Kong.

19. In reply, CE/HKMA explained that under MIP, HKMC provided mortgage insurance cover at a fee to the insured (i.e. the banks) for an amount up to 25% of the property value, which enabled the insured to advance mortgage loans of up to 95% of the property value without taking additional risks. CE/HKMA pointed out that with the provision of mortgage loans up to 95% under MIP, the number of mortgage loans in negative equity would become more sensitive to the drop in property prices, as a property with mortgage loan of up to 95% would be recorded as negative equity on the books of the bank if the value of the property dropped by an extent of reducing the value of the property below 95% of its value at the time when the loan was drawn down. The increase in the number of residential mortgage loans in negative equity on the books of banks did not necessarily mean a corresponding deterioration in the quality of mortgage loans. Banks were still adhering to the 70% loan-to-value-ratio rule. The additional top-up portion of the mortgage loans were covered by mortgage insurance, either through HKMC or other insurers. While the number of residential mortgage loans in negative equity had reduced significantly from the peak in 2003, CE/HKMA was mindful of the possible impact of the recent increase in the number and fully appreciated the difficulty faced by as well as the impact on the property buyers with mortgage loans in negative equity. He hoped that the burden on property buyers would lessen with the expected stabilizing of the US interest rates. He however pointed out that as far as risk management of the banking sector was concerned, CARs of banks were maintained at a healthy level as banks continued to observe the guideline on the 70% loan-to-value ratio for mortgage loans.

20. Mr Jeffrey LAM further enquired about the impact of the increase in the number of mortgage loans in negative equity on the development of the mortgage business. CE/HKMA said that given the keen competition of the banking sector, banks would adjust the discount of the mortgage rate against the prime rate accordingly to maintain a reasonable net interest margin on mortgages. HKMA had computed the "composite rate" as an alternative for the reference of banks in setting mortgage rates and better managing their risks. Nevertheless, it was for individual banks to make their own decisions on the reference rate to be used for setting mortgage rates.

Positive data sharing

21. Referring to pages 34(a) and 34(d) of the presentation material provided by HKMA highlighting the benefits of positive data sharing, Ms Emily LAU requested CE/HKMA to elaborate on the benefits achieved. She also enquired whether HKMA had received any complaints on abuse of consumer credit information obtained from the Credit Reference Agency (CRA) database in the past two years.

22. In reply, CE/HKMA advised that with the introduction of positive data sharing, financial institutions had fuller information to assess the creditworthiness of

their customers in assessing credit applications and conducting credit reviews. In general, consumers benefited from cheaper non-card credits as financial institutions were more comfortable in underwriting consumer loans with positive data sharing. According to the industry, interest rates for these consumer loans were on average 6% to 10% lower than that of debt incurred through credit cards. CE/HKMA also pointed out that HKMA had not received any complaints against misuse/abuse of data nor customers failing to obtain credits as a result of positive data sharing. Responding to Ms Emily LAU's further enquiry, CE/HKMA advised that the requirements for credit providers to notify customers pertaining to the use of the CRA database for assessing credit applications and conducting credit reviews were stipulated in the Code of Practice on Consumer Credit Data issued by the Office of the Privacy Commissioner for Personal Data.

Impact of branch closure by banks on the public

23. Mr CHAN Kam-lam was concerned that given the narrowing interest spreads in a competitive operating environment of the banking sector, the implementation of Basel II in Hong Kong would have adverse impact on the quality of bank services, as banks might have to increase fees and commissions or reduce the number of branches to cover the increase in operating cost for meeting the new capital and disclosure requirements under the Basel II. Mr CHAN sought CE/HKMA's analysis in this regard.

24. CE/HKMA responded that while cost would inevitably be incurred by banks in complying with the requirements under the Basel II, the banking sector would eventually benefit from the prudent "risk-based" principle for business operation. To facilitate the banking sector in striking a balance between cost-effectiveness and maintenance of service quality, the Hong Kong Association of Banks (HKAB) could play a role in liaising with its members to work out measures to address consumer issues arising from provision of banking services, such as the impact of branch closure by banks on the public. HKMA had no statutory authority, nor was this its function, to give direction to banks on what was essentially a commercial decision. Nevertheless, HKMA was ready to assist in the communication on issues between the banking industry and the community.

25. Mr CHAN Kam-lam suggested that the feasibility of providing some banking services through other institutions, such as post offices, be explored. In response, CE/HKMA advised that under the Banking Ordinance (Cap. 155), only licensed banks might operate current and savings accounts, and accept deposits of any size and maturity from the public and pay or collect cheques drawn by or paid in by customers. While some financial services, such as credit services, could be provided by other licensed institutions, the provision of these services was subject to market demand.

26. Noting from CE/HKMA's reply dated 27 January 2006 that HKAB was going to establish a working group to look into ways to alleviate the effects of branch closure and facilitate access to services, Ms Emily LAU was concerned whether the

working group would take into consideration the social responsibility of banks in the provision of banking services for their customers.

27. CE/HKMA responded that the social responsibility of commercially run banks was subject to interpretation by individual banks. He stressed that the consumer issues arising from the closure of bank branches could best be resolved through communication between the banking industry and the community at large. HKMA would provide any assistance required of it in the deliberation of these issues, in collaboration with HKAB and LegCo Members. While pointing out that any suggestion for HKMA to define the social responsibility of banks might run the risk of going against the principle of a free market, CE/HKMA fully appreciated the concern of the public on the provision of banking services, in particular for the residents of areas far from the city centre. When looking into ways to alleviate the effects of branch closure and facilitate access to services, CE/HKMA said that it was important to strike a balance between customer demand and banks' cost-benefit analyses.

28. Ms Emily LAU remained concerned about the impact of the closure of bank branches on the public. She agreed that feasible proposals acceptable to the parties concerned might be worked out through communication with the banking industry. She therefore requested that representatives of HKAB and the Consumer Council be invited to a meeting of the Panel to discuss the subject. Mr SIN Chung-kai supported Ms LAU's request and suggested that all non-Panel Members be invited to join the discussion. Mr SIN also suggested that HKAB be invited to provide information on the number of branches closed by banks since the deregulation of interest rate rules. The Chairman directed the Clerk to take follow-up actions accordingly.

Regulation of banks' securities business

29. Referring to CE/HKMA's earlier remark on the "deep-rooted dilemma" in the financial field, Mr CHIM Pui-chung expressed grave concern about the intense competition faced by the securities intermediaries due to the expansion of securities business by the banking sector. In this connection, he considered that the present arrangement for the regulation of the securities business of banks and other securities intermediaries by different regulators, namely HKMA and SFC, was undesirable and unfair to local securities intermediaries. Mr CHIM urged CE/HKMA to review the present regulatory arrangement instead of criticizing local securities intermediaries by implying that they were protecting their own interest at the expense of the interest of the public at large.

30. In reply, CE/HKMA clarified that his remark about the "deep-rooted dilemma" in the financial field was not a criticism against local securities intermediaries. It referred to the conflict between the public interest in ensuring effective financial intermediation and the private interest of financial intermediaries in maintaining their business. Indeed, the advancement in information technology in recent years had brought about a fundamental change in the mode of delivery of

services to customers in securities transactions. CE/HKMA fully appreciated the concern of securities intermediaries about the need to maintain their business. However, he pointed out that if one day the stock market adopted a fully computerized trading and custodian system linked with the electronic money payment and settlement system, the question about the role of securities intermediaries might be raised.

31. As to Mr CHIM Pui-chung's request for a review of the current regulatory arrangement for the securities industry, CE/HKMA pointed out that the arrangement was supported by a large number of respondents and stakeholders during the consultation of the Securities and Futures Bill and endorsed by the LegCo in the enactment of the Securities and Futures Ordinance (Cap. 571). If the current regulatory arrangement was to be replaced, the question of one business corporation to be regulated by two regulators would have to be resolved.

Investment income of EF

32. Referring to page 41 of the presentation material provided by HKMA, Mr SIN Chung-kai expressed concern about the criteria adopted by EFAC in determining the investment benchmark of EF. Noting that the investment income of EF had been dragged down by the decline in value of foreign currency reserves held in non-US dollar assets, Mr SIN queried the rationale for determining the currency mix, in particular the amount of foreign currency reserves held in non-US dollar assets, and whether the amount should be reduced to minimize the adverse impact on the investment income of EF.

33. In reply, CE/HKMA explained that EFAC determined the long-term asset allocation strategy of EF, governed by investment benchmark which defined the allocation of investments to different asset classes by country and by sector as well as the overall currency mix for the Fund. The investment strategy of EF was determined by the objectives of capital preservation, liquidity, full backing of the Hong Kong dollar Monetary Base, and maintaining the long-term purchasing power of the assets. Under the investment benchmark, flexibility was allowed for tactical deviations to the asset mix and currency mix in the management of EF. As regards the return of foreign currency reserves in non-US dollar assets, CE/HKMA explained that when the US dollar was strong, the value of this component in terms of Hong Kong dollar would decline because of the link between the Hong Kong dollar and the US dollar. The strength of the US dollar in 2005 had thus dragged down the investment income of EF. CE/HKMA also pointed out that optimal use of assets in different foreign currencies would benefit the investment return of EF in the long run.

34. Mr CHAN Kam-lam was concerned whether CE/HKMA had explored with the Financial Secretary (FS) on means to improve the existing sharing arrangement which determined the Treasury's share of the investment income of EF. CE/HKMA responded that FS and he himself did not have different views on the sharing arrangement. He further explained that under the existing sharing arrangement, the

Treasury's share of the investment income of EF fluctuated from year to year and might not always meet the Treasury's projected return. Nevertheless, having regard to the difference in the investment strategy of EF from other investment funds, assessment of its investment return should not be made only on the basis of whether the target set by the Treasury was met.

Policies on remuneration for and post-termination employment of HKMA's senior executives

35. Noting from CE/HKMA's written reply dated 27 January 2006 that the Governance Sub-Committee of EFAC was currently reviewing the rules on post-termination employment for HKMA staff, Ms Emily LAU enquired about the target date for completing the review. In reply, CE/HKMA assured members that HKMA would provide any information and assistance as required by the Governance Sub-Committee to facilitate the conduct of the review. Nevertheless, he was not in a position to decide on the target completion date on behalf of the Sub-Committee.

36. Noting the four objectives of the review set out in CE/HKMA's written reply, Ms Emily LAU considered that the objectives of the review should be confined to that adopted by the Administration in conducting the review of the policy governing post-service employment of former directorate civil servants, i.e. to ensure that former directorate civil servants would not enter into business or take up employment which might constitute conflict of interest (real, potential or perceived) with their former government duties or cause negative public perception embarrassing the Government and affecting the image of the civil service. Ms LAU also opined that the existing arrangements governing the post-termination employment of HKMA senior staff were inadequate in safeguarding against conflict of interests. She urged the Governance Sub-Committee to expedite the review of the existing arrangements with a view to strengthening the control in this regard. In particular, reference should be made to the improvement measures introduced for the civil service on 1 January 2006, which were finalized after consultation and detailed consideration. For example, former directorate civil servants at D4 or above (or equivalent) would be subject to a minimum 12-month sanitization period so as to forestall real or potential conflict of interest and/or negative public perception by instituting a 12-month break between the officer's government duties and outside work.

37. CE/HKMA undertook to convey Ms Emily LAU's concern to the Governance Sub-Committee. He nevertheless pointed out that in reviewing the rules on post-termination employment for HKMA staff, it was important to take into consideration that any revised arrangements should not undermine the mobility of skills in the financial services sector and other sectors that were of benefit to achieving the objectives of HKMA.

38. Referring to Annex 4 to the Administration's reply to the oral question raised by Hon KWONG Chi-kin at the LegCo meeting on 14 December 2005, Mr SIN Chung-kai noted that an employee of HKMA at the level of Senior Manager

to Deputy Chief Executive must obtain prior approval of the Monetary Authority (CE/HKMA), and in the case of the Monetary Authority he must obtain approval of FS, before he/she could become an employee of another organization/corporation/firm in Hong Kong within six months from the termination of his/her employment with HKMA. Mr SIN suggested that all senior executives at the levels of Executive Director and Deputy Chief Executive should be required to obtain prior approval from the Governance Sub-Committee before taking up new employment within the control period. CE/HKMA undertook to convey Mr SIN's suggestion to the Governance Sub-Committee for consideration.

39. On remuneration policies, Mr LEE Cheuk-yan reiterated his view expressed at previous Panel meetings that the present remuneration level of CE/HKMA was on the high side. In particular, Mr LEE was concerned that the remuneration level of CE/HKMA was much higher than that of FS, to whom he reported, and that of the Chairman of the US Federal Reserve Board. In this connection, Mr LEE requested that the Governance Sub-Committee be invited to provide information on the remuneration policies applicable to senior executives of HKMA, including the criteria and factors for consideration in determining the remuneration package for CE/HKMA and other senior executives of HKMA, and the mechanism for pay review. The Governance Sub-Committee should also be invited to consider his suggestion that in line with civil service pay policy, the remuneration for CE/HKMA should be set at a fixed level, and the variable pay component should be removed.

40. CE/HKMA explained that his remuneration package and those of other senior executives of HKMA were determined by FS on the advice of EFAC and the recommendations of the Governance Sub-Committee. A mechanism was in place for setting and reviewing the remuneration levels of HKMA's staff, with reference to the remuneration levels of the financial sector. As to whether the present remuneration levels of senior executives of HKMA were on the high side, CE/HKMA said that he would not make any comment on this. However, as a matter of fact, HKMA was experiencing the loss of talent and recruitment difficulties.

41. Mr LEE Cheuk-yan suggested that the Governance Sub-committee be invited to a meeting of the Panel to discuss with members on the policies on remuneration for and post-termination employment of senior executives of HKMA. To facilitate the Panel to consider how the matter should be taken forward, the Chairman suggested and members agreed that the Governance Sub-Committee be invited to consider the views expressed by members at the meeting and provide the information requested by members. The Panel would consider the way forward after receipt of the Governance Sub-Committee's reply.

(*Post-meeting notes:*

(a) The Clerk to Panel's letter to the Chairman of the Governance Sub-Committee and the reply from the Chairman were issued to members on 16 March 2006 vide LC Paper Nos. CB(1)1092/05-06(01) and (02) respectively; and

(b) During the discussion on Agenda Item V of this meeting, members agreed that SFC should also be invited to provide information on the policies on remuneration for and post-termination employment of its senior executives. On post-termination employment, SFC should be invited to consider the need to review the existing policy in the light of the new arrangements for post-service employment of former directorate civil servants promulgated in January 2006.)

V. Progress report on proposed measures to address risks arising from securities margin financing

(LC Paper No. CB(1)454/05-06(01) — Securities and Futures Commission's Progress Report on Proposed Measures to Address Risks Arising from Securities Margin Financing

LC Paper No. CB(1)806/05-06(10) — Background brief prepared by the Legislative Council Secretariat)

42. The Chairman advised that when the Panel was briefed on 17 December 2004 on the progress of the public consultation on the proposed measures to address risks arising from securities margin financing (SMF), members had requested the Administration and the Securities and Futures Commission (SFC) to report further progress to the Panel in a year's time. The SFC had subsequently provided a progress report on 2 December 2005. At the request of members, the Administration and the SFC were invited to brief the Panel on the progress report.

Briefing by the SFC

43. At the invitation of the Chairman, Mrs Alexa LAM, Executive Director, Intermediaries and Investment Products of the Securities and Futures Commission (SFC) gave a power-point presentation on the progress of proposed measures to address risks arising from business of SMF. She highlighted the following points:

(a) The collapse of C.A. Pacific Group in 1998 triggered a confidence crisis among retail investors who rushed to withdraw shares from other broker firms. Hong Kong could not afford a repeat of a brokerage collapse like C.A. Pacific again.

(b) Although measures had been taken to reduce the risks arising from SMF activities, pooling risks remained a loophole in the existing regulatory regime. Once a client had opened a margin account with a broker and authorized the broker to re-pledge his securities, the broker might re-pledge the client's securities without any limits, even when the client had no current borrowing from the broker. Many major

financial centres already had laws and regulations in place to protect the interests of consumers in this regard.

(c) Despite SFC's investor education efforts, there were still investors who did not fully understand the risks associated with margin accounts and the implications of entering into a margin account agreement. Appropriate regulations should therefore be introduced to protect consumers' interests accordingly.

(d) In 2002, the SFC set up a working group to review the existing regulatory framework for managing brokers' financial risks. The SFC published the working group's report for public consultation in 2004. The two principal measures put forward in the report were the imposition of a limit on the amount of margin clients' collateral that a firm could re-pledge to secure its borrowing, and the increase in the haircut percentages applied to margin clients' collateral under the Financial Resources Rules (FRR). On the proposed re-pledging limit, the report recommended the limit be set at 130% - 150% of the total amount of margin loans lent out by a firm. There was general support for a reform of the existing regulatory framework in order to enhance investor protection. However, industry participants were concerned that their interests would be affected by the proposed re-pledging limit.

(e) The SFC had devoted a great deal of efforts to work with the industry with a view to setting a re-pledging limit at a mutually acceptable level. However, no consensus had been reached by the industry. The SFC considered that the matter should not be allowed to drag on further. As revealed by the statistics as of September 2005, the proposed re-pledging limit would not be applicable to nearly 80% of the 431 broker firms in Hong Kong since they did not re-pledge clients' collateral. As to the remaining 84 firms which re-pledged clients' collateral, most of them were already able to comply with the proposed re-pledging limit because they did not re-pledge excessively. Therefore, only a limited number of broker firms would be affected by the proposal.

(f) The SFC firmly believed that increased investor confidence in both the market and the brokerage industry would bring long-term benefits to the development of the market and the industry. Moreover, it was crucial to protect the interests of the 1.3 million retail investors in Hong Kong, and maintain the reputation of Hong Kong's securities market and its position as an international financial centre for the benefit of Hong Kong as a whole. The SFC therefore planned to implement the proposed re-pledging limit. To allow time for the

brokers concerned to prepare for the change, a two-stage approach would be adopted, as follows:

- The SFC would publish the consultation conclusions and submit the draft legislation to the Legislative Council (LegCo) as soon as practicable, with a view to implementing the re-pledging limit of 180% soonest after completing the legislative process; and

- After a further period of 12 months, the re-pledging limit would be fixed at a level of between 130% and 150%, i.e. allowing brokers about 18 months to prepare for compliance with the 130% - 150% re-pledging limit.

(g) The SFC believed that the two-stage approach had struck an appropriate balance that took into account the interests of all stakeholders. Given the concerns about the costs involved in complete segregation of borrowing and non-borrowing margin clients' collateral, the SFC considered that in the short to medium term, the imposition of re-pledging limit was a practical way forward to reduce pooling risks.

(*Post-meeting note:* Mrs Alexa LAM's speaking notes and presentation material were issued to members of the Panel and non-Panel members vide LC Paper No. CB(1)850/05-06(01) and (02) respectively on 7 February 2006.)

Discussion

Imposition of re-pledging limit on SMF providers

44. Given that eight years had passed since the collapse of C.A. Pacific Group in 1998, Mr SIN Chung-kai expressed disappointment at the slow progress achieved by the SFC in taking forward the proposed measures to address risks arising from SMF. While recognizing that the imposition of a re-pledging limit on SMF providers was a less preferred option to complete segregation of borrowing and non-borrowing margin clients' collateral, Mr SIN urged for the early implementation of the re-pledging limit as a first step to enhance protection for investors. He also pointed out that the current robust stock market provided a favourable environment for implementation of the proposed measures since it would minimize the possible negative impact on the business of SMF providers. In this connection, Mr SIN requested the Administration to provide a concrete timetable for presenting the relevant proposed legislative amendments to the LegCo.

45. Mr CHAN Kam-lam said that the LegCo Members of the Democratic Alliance for the Betterment and Progress of Hong Kong supported the proposal of imposing a re-pledging limit on SMF providers. Ms Emily LAU considered that the SFC should

implement the proposal as soon as possible. While expressing support for the proposal, Mr Ronny TONG shared members' concern about the slow progress in taking forward the proposed measure. He also considered the proposal conservative.

46. Mrs Alexa LAM reiterated that the proposed two-stage approach for implementing the re-pledging limit had striven to strike a proper balance that took into account the interests of all stakeholders. On the timetable for introducing the legislative amendments, Mrs LAM advised that the SFC was finalizing the amendments to the FRR and would consult the Administration on the details shortly. The Deputy Secretary for Financial Services and the Treasury (Financial Services) said that the Administration would work closely with the SFC on the draft amendment rules which would be subject to negative vetting of the LegCo. She assured members that the Administration would present the proposed legislative amendments to the LegCo as soon as possible.

47. Mr SIN Chung-kai and Mr Ronny TONG were concerned how far the proposed re-pledging limit could protect the interests of non-borrowing clients. Mrs Alexa LAM explained that imposition of the re-pledging limit would prevent SMF providers from excessively re-pledging clients' collateral with banks and thus reducing pooling risks on margin clients. The re-pledging limit represented a limit on the amount of clients' collateral that a SMF provider could re-pledge to banks to secure borrowing. For instance, if a per-firm limit of 150% was imposed, a SMF provider who had lent an aggregate of $100 million to all its margin clients would be allowed to re-pledge clients' collateral worth not more than $150 million. The measure would result in a SMF provider re-pledging a smaller proportion of clients' collateral with banks, thus increasing the amount of clients' collateral available for distribution in the event of the SMF provider's collapse. Mrs LAM also clarified that SMF providers were prohibited from pooling and re-pledging collateral of cash clients. Hence, cash clients were not subject to pooling risks. Nevertheless, she agreed with members that the ultimate solution for addressing pooling risks was to completely segregate the collateral of borrowing and non-borrowing margin clients.

48. Mr CHIM Pui-chung declared interest that he was a LegCo Member returned from the financial services functional constituency. While stressing the need to enhance protection for investors, Mr CHIM queried the effectiveness of the proposed re-pledging limits in reducing the risks arising from SMF. He considered that the SFC, as a market regulator, should seek to balance the interests of all stakeholders, educate the investing public and enhance the business of the brokerage industry. Given that only seven SMF providers re-pledged clients' collateral excessively, the SFC should strengthen its monitoring work on them instead of implementing a re-pledging limit on all SMF providers. With a view to enhancing investor protection, Mr CHIM called on the SFC to consider requiring brokers to transfer clients' shares to the investor participant (IP) accounts at the Central Clearing and Settlement System within 48 hours after transactions and no fees should be charged for the service.

49. In response, Mrs Alexa LAM re-iterated that pooling risks remained a loophole in the existing regulatory regime. Once a client had opened a margin account with a broker and authorized the broker to re-pledge his securities, the broker might re-pledge the client's securities without any limits, even when the client had no current borrowing from the broker. The proposed measure aimed at plugging the loophole and preventing excessive re-pledging of clients' collateral by any SMF providers. As regards the suggestion of implementation of IP account system, Mrs LAM said that while the SFC encouraged cash clients to set up IP accounts, such accounts could not address the risk associated with re-pledging of margin clients' collateral. It was because in margin finance business, a SMF provider took its clients' collateral into its possession or control. These shares would not be held in the clients' own names and thus could not be kept in their IP accounts.

Cost implications of the re-pledging limit

50. Mr CHAN Kam-lam expressed concern about the cost implication of the re-pledging limit on SMF providers and investors. Mrs Alexa LAM said that according to studies conducted by the SFC, the vast majority of the 84 broker firms which currently adopted re-pledging practice were already able to comply with the measure, and only seven firms might be required to obtain alternative funding in order to comply with the 130% - 150% re-pledging limit. Additional cost would be incurred by SMF providers as they needed to set up new systems for implementing the proposed re-pledging limit.

51. Ms Emily LAU requested the SFC to provide information on the number of SMF providers that were likely to be affected by the 180% re-pledging limit. Mrs Alexa LAM agreed to provide the information after the meeting.

52. Given that SMF providers had re-pledged clients' collateral for financing their working capital, Mr Ronny TONG opined that the additional administrative costs involved should be borne by the SMF providers or the borrowing margin clients and should not be passed on to non-borrowing margin clients or cash clients. Mrs Alexa LAM explained that a certain degree of cross subsidization in service fees existed among different clients. Through pooling clients' collateral for re-pledging to banks, a SMF provider was able to obtain more favourable terms for its loan thus reducing its operating cost. This would be beneficial to all clients of the SFM provider as it would charge lower service fees.

Protection of investors' interests

53. Noting that the SFC had been discussing with the industry to address their concerns about implementation of the proposed measures, Mr SIN Chung-kai enquired whether the SFC had consulted the investors to ascertain their views. Mrs Alexa LAM advised that the SFC had been holding discussions with the brokerage industry in the past few years with a view to reaching a consensus on the appropriate measures to be adopted for addressing risks arising from SMF and the implementation timetable. The SFC had devoted a great deal of efforts to educate investors about the risk of authorizing their SMF providers to re-pledge their securities, and had undertaken an investor survey to gauge investors' views on pooling risks. The SFC was fully aware of investors' concern about pooling risks and the majority's view that pooling and re-pledging of clients' collateral by SMF providers should not be allowed to continue.

54. Referring to paragraph 15 of the paper provided by the Administration, Mr CHAN Kam-lam enquired about the industry's view on the proposal of making known to the public the names of SMF providers which did not pool and re-pledge clients' collateral. Mr Ronny TONG and Ms Emily LAU welcomed the proposal so as to enhance transparency of SMF providers' business practices.

55. Mrs Alexa LAM responded that the 84 SMF providers with re-pledging practice had divergent views on the proposal. However, the SFC supported any measures to enhance transparency and facilitate investors to make informed decisions. She added that possible options for implementing the proposal mentioned in paragraph 15 of the paper included introducing a categorization system on SMF providers stating clearly in their licences whether they adopted pooling and re-pledging practice, or disclosing information on such practices of SMF providers in the register of licensees and registrants maintained by the SFC which was available for public inspection. Mrs LAM said that the SFC would explore with the brokerage industry on viable measures to increase the transparency of SMF providers' re-pledging practice.

Complete segregation of borrowing and non-borrowing margin clients' collateral

56. Mr Ronny TONG considered that as a matter of principle, SMF providers should not be allowed to re-pledge the collateral of non-borrowing margin clients. Ms Emily LAU concurred with Mr TONG's views and urged that the SFC should ban pooling and re-pledging practice as early as possible with a view to enhancing investor protection and enabling Hong Kong's regulatory system to meet international standards.

57. In response, Mrs Alexa LAM agreed that the imposition of a re-pledging limit was inadequate to solve the problem of pooling risks. She stressed that it remained the long term goal of the SFC to achieve complete segregation of borrowing and

non-borrowing margin clients' collateral. The proposal of imposing the re-pledging limit was a step forward in this direction. While recognizing that many major financial centres already had laws and regulations to prohibit brokers from re-pledging non-borrowing margin clients' collateral, Mrs LAM said that pooling and re-pledging of clients' collateral was a long established practice of the securities industry in Hong Kong for SMF providers to finance their working capital. In order to ensure the viability of business of SMF providers, the SFC would further assess the possible consequences of the proposal of complete segregation and examine how it could be implemented cost-effectively.

58. Referring to paragraph 10 of the paper provided by the Administration, Ms Emily LAU noted that a medium-sized SMF provider envisaged that it might have to incur as much as $500,000 additional administrative costs per month as a direct result of the segregation requirement. Noting the significant cost implications on SMF providers, the Chairman and Ms LAU expressed concern that the additional costs might be passed on to investors. They pointed out that while investors welcomed the measure of complete segregation, they might not fully understand the impact on services fees paid by them. They therefore requested the SFC to provide information on the impact of complete segregation on borrowing and non-borrowing margin clients, including the likely increase in service fees paid by them. In this connection, they suggested that the SFC should step up its efforts to educate investors on such likely cost impact on them.

59. Mr CHAN Kam-lam also requested the SFC to provide information on the impact of the proposal of complete segregation on the operating cost of SMF providers, including the respective impacts on small, medium and large-sized SMF providers.

(*Post-meeting note:* The SFC's written response to members' requests in paragraphs 51, 52, 58 and 59 above was issued to members of the Panel and non-Panel Members vide LC Paper No. CB(1)1023/05-06(01) on 3 March 2006.)

Conclusion

60. In concluding the discussion, the Chairman urged the Administration and the SFC to implement the proposed measures to address risks arising from SMF as soon as possible and to work out a concrete timetable for implementation of the measures.

VI. Briefing on the draft Mandatory Provident Fund Schemes (General) (Amendment) Regulation 2006

(LC Paper No. CB(1)806/05-06(11) — Paper provided by the Administration)

Briefing on the proposed amendments

61. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Financial Services) ((DS/FST(FS)) advised that since the implementation of the Mandatory Provident Fund (MPF) system in December 2000, the Mandatory Provident Fund Schemes Authority (MPFA) had constantly strengthened and refined the system to ensure that it was in line with the prevailing market practices and serving the best interests of MPF scheme members. In August 2001, the MPFA established the MPF Schemes Operation Review Committee (SORC) for undertaking review of the operational aspects of the MPF legislation for further improvements. The SORC had completed a series of reviews on investment regulations set out in the MPF Schemes (General) Regulation (the Regulation). In the light of the recommendations put forward by the MPFA, the Administration intended to introduce proposals to amend the Regulation with the aim to enhance protection of scheme members' interests, improve operation of the Regulation, enhance flexibility of MPF investments and remove undue restrictions on investment of MPF funds. The Administration planned to introduce the MPF Schemes (General) (Amendment) Regulation (the Amendment Regulation) into the Legislative Council (LegCo) through the positive vetting procedure within the 2005-06 legislative session to give effect to the proposals.

62. Mr Darren McShane, Executive Director (Regulation and Policy), MPFA pointed out that the proposed amendments mainly covered Schedule 1 to the Regulation which regulated the permissibility of investments of MPF funds. He then briefed members on the proposals covered in the Amendment Regulation (paragraphs 6 to 28 of the paper provided by the Administration).

Discussion

Proposals to enhance flexibility of MPF investments

63. Noting the Administration's proposal to amend section 8(1) of Schedule 1 to the Regulation to empower the MPFA to assess the permissibility of "listed securities" as permissible investments of MPF fund (paragraphs 19 and 20 of the paper), Mr Ronny TONG enquired whether the MPFA had considered the alternative of providing a list of permissible investment products for MPF funds. Mr TONG was concerned that relaxation in the permissibility of "listed securities" would allow MPF funds to be invested in high-risk financial products, such as derivative warrants. He also enquired whether a regulatory regime for investment managers was in place to safeguard the interest of MPF scheme members.

64. In response, Mr Darren McShane explained that the existing rules already contained the permissibility requirements for derivative instruments and it was not envisaged that the proposed amendments would change the existing mechanism. There was also an ongoing supervision process for the trustees. MPFA was implementing a set of compliance standards to enhance trustees' supervision of the investment managers. As regards investments permitted under the new power, they would be listed in the guidelines which were available on the website of the MPFA.

Legislative timetable

65. Mr LEE Cheuk-yan enquired about the concrete timetable for the Administration to introduce the proposed amendments to the LegCo. DS/FST(FS) advised that the Department of Justice, in consultation with the MPFA, had commenced the drafting of the Amendment Regulation. It was envisaged that the finalized draft would be ready within three to four months. The Amendment Regulation would then be submitted to the Executive Council (ExCo) for its consideration and subject to ExCo's approval, to the LegCo for positive vetting. He stressed that the Administration would endeavour to introduce the Amendment Regulation to the LegCo as soon as possible.

Review of the MPF system for enhancing protection of scheme members' interests

66. While expressing support for the review on investment regulations to enhance the protection of scheme members' interests, Mr CHAN Kam-lam considered that other issues relating to the MPF system should also be reviewed. He called on the Administration and the MPFA to consider a proposal put forward by the Democratic Alliance for the Betterment and Progress of Hong Kong to put in place a "pass-book" account system where employees would be allowed to choose their own MPF schemes instead of joining the schemes selected by their employers. Under such system, an employee's account would be portable and the same account would be used to receive MPF contributions when the employee changed his job. This proposal would provide more flexibility for employees in selecting their MPF schemes and managing their MPF investments, and would save cost for managing MPF accounts. Mr CHAN further enquired about the estimated number of MPF preserved accounts, i.e. illiquid accounts which were not receiving on-going MPF contributions, and the annual operating cost for managing such accounts.

67. In reply, Mr Darren McShane advised that currently there were approximately 1.8 million preserved accounts and the number was less than that of active contribution accounts. He clarified that preserved accounts were not illiquid but just not receiving regular contributions. Such accounts were also not dormant as the funds continued to be invested. As an initiative to improve the preserved accounts, the MPFA was considering proposals in consultation with the industry of allowing preserved accounts to accept voluntary contributions. Moreover, the MPFA was making efforts to improve disclosure. It would consult members in the coming

months regarding proposed improvements to the annual benefit statement. The MPFA was also reviewing the MPF system, including the merits of the "pass-book" account system.

68. As regards the operating cost for preserved accounts, Mr McShane said that from the investment perspective, funds in the preserved accounts were invested in the same way according to the investment mandate of the fund. There would be no major cost difference between preserved and regular accounts for members. In fact, from the trustee's perspective, the costs might even be lower to operate preserved accounts because of lower frequency of contributions.

69. Mr LEE Cheuk-yan expressed concern about the lack of protection for employees whose employers had not registered them with any MPF schemes. He considered that the Administration and the MPFA should address the problem and other operational problems of the MPF system.

70. DS/FST(FS) said that in addition to the proposed amendments to the Regulation, the SORC had been reviewing other operational aspects of the MPF system to identify areas for improvement. He was aware that the MPFA had started its work in formulating relevant rules and guidelines to facilitate implementation of those recommendations which did not require legislative amendments. Mr Darren McShane undertook to provide information about the progress on review of contribution and recovery issues for enhancing the protection for employees and scheme members. At the request of Mr LEE Cheuk-yan, Mr McShane also agreed to provide information on MPFA's plan and proposal(s) for addressing the concern mentioned in paragraph 69 above.

(*Post-meeting not*e: MPFA's written response to the request in paragraph 70 above was issued to members vide LC Paper No. CB(1)1119/05-06(02) on 21 March 2006.)

71. Mr LEE Cheuk-yan suggested that a joint meeting of the Panel on Financial Affairs (FA Panel) and the Panel on Manpower (Manpower Panel) be arranged for Members to discuss the operational problems of the MPF system for enhancing the protection of employees' interests. Given that the focus of concern was related to employees' interests, the Chairman considered it more appropriate for the subject to be discussed by the Manpower Panel, if the Panel so agreed. Members of the FA Panel might be invited to join the discussion. Mr LEE agreed with the Chairman's view. As a member of the Manpower Panel, he would raise the subject for discussion by the Panel.

Conclusion

72. There being no further questions from members, the Chairman concluded the discussion. He concluded that the FA Panel supported in principle the proposed amendments to the Regulation.

VII. Any other business

73. There being no other business, the meeting ended at 12:17 pm.

Council Business Division 1
Legislative Council Secretariat
31 March 2006