

30 June 2006

Clerk to the Legislative Council Panel on Financial Affairs  
Legislative Council Building  
8 Jackson Road  
Central, Hong Kong  
(Attn : Miss Salumi Chan)

Dear Miss Chan,

Panel on Financial Affairs  
Follow-up to the meeting on 4 May 2006

Thank you for your letter dated 10 May 2006 inviting the Governance Sub-Committee (GSC) of the Exchange Fund Advisory Committee (EFAC) to comment on the research report prepared in 2003 by the Legislative Council Secretariat Research and Library Services Division on *The Governance of the Hong Kong Monetary Authority and Comparable Authorities in Hong Kong and Overseas Jurisdictions*. The GSC has now had an opportunity to consider the report and the written response to it made by the HKMA at the time. This letter sets out the comments of the GSC.

General Comments

For the purposes of this response, the GSC assumes statements made in the report are factually correct; in the interest of saving time and resources, it has not verified them. The GSC has concentrated on the governance arrangements of the three central banks set out in the report, since those for non-central banks are less relevant to the HKMA. The GSC considers that, while comparisons with other central banks are helpful, the governance arrangements of central banks vary widely according to historical factors, the characteristics of the markets in which they operate, their designated functions and responsibilities, and the political and legal systems of their jurisdictions. There is no single system that fits all central banks and reference should therefore be drawn from the practices of other institutions only in so far as they are relevant and appropriate to Hong Kong's circumstances. The GSC notes and agrees with the written response given by the HKMA in 2003 and believes that it is still valid. Against this background, the GSC has the following observations

- (a) The report was prepared in 2003 and has not been updated. It therefore does not take account of a number of changes introduced since then:

- On 25 June 2003 the division of functions and responsibilities between the Financial Secretary and the Monetary Authority (MA) was set out in an exchange of letters between the two. The exchange of letters also disclosed the delegations made by the Financial Secretary to the MA under the Exchange Fund Ordinance and other ordinances. At the same time, the Financial Secretary stated the monetary policy objective and the structure of the monetary system for Hong Kong. These documents, which are public, bring together and summarise in one place the main functions of the Financial Secretary and the MA under the legislation relating to monetary and financial stability. They also play an important part in defining the autonomy of the HKMA in its day-to-day work. The documents were sent to you by the HKMA on 27 June 2003. Copies are attached to this letter for ease of reference.
  - In May 2004 the HKMA disclosed its annual administrative budget for that year at the regular briefing by the Chief Executive of the HKMA (CE/HKMA) to the Panel. The HKMA began publishing its annual administrative budget for the current year in its Annual Report in 2005 and will continue to do so in future Annual Reports.
  - In 2004 the sub-committee system of EFAC was developed to ensure that each of the main areas of the work of the HKMA (other than supervision of authorized institutions, which is in the purview of the Banking Advisory Committee or the Deposit Taking Advisory Committee) is monitored by a Sub-Committee, which also makes recommendations to the Financial Secretary through EFAC. In addition, the former Remuneration and Finance Sub-Committee was replaced by the GSC, which comprises the non-official and non-banking sector members of EFAC and is chaired by a non-official member. This step was taken specifically to further improve the oversight of governance matters at the HKMA.
  - In 2003 the HKMA began including a table in its Annual Report showing the remuneration of the Chief Executive (CE/HKMA) and the average remuneration of Deputy Chief Executives and Executive Directors. The remuneration policy of the HKMA was set out in a paper sent to the Panel on 2 February 2004 and is also provided on the HKMA's website.
- (b) The report considers only three overseas central banks: the US Federal Reserve, the Bank of England (BoE), and the Monetary Authority of Singapore (MAS). While these are useful comparators, they are a small sample. As noted earlier, the GSC also believes that reference should

be drawn from the practices of other central banks only when they are relevant and appropriate to the circumstances of Hong Kong.

- (c) The functions of the three central banks considered vary widely and some functions carried out by central banks in other jurisdictions are undertaken by other agencies in the countries covered. This underlines the difficulty of comparing central banks directly with each other, although some common features and principles can be identified and usefully referred to.
- (d) The disclosure of budget information by the HKMA since 2004 compares favourably with that of the three central banks considered in the report. The HKMA also compares favourably in this respect with most major central banks around the world.
- (e) The report confirms that the three central banks studied all have a large measure of resource independence and their administrative budgets are not subject to approval by the legislature.
- (f) There is no uniform method of determining staff remuneration among the three central banks considered: the MAS bases its compensation on that of the financial markets; the BoE refers to market information from the private and public sectors; the Federal Reserve links pay to civil service salary structures.
- (g) The GSC has not found anything in the information contained in the report about these three central banks that suggests that the current governance arrangements need to be changed. The GSC will, however, continue to keep these matters under review and recommend any changes it feels are necessary or desirable.

#### Responses to Specific Questions

The GSC's responses to the questions in paragraph 3 of your letter (in the same order) are:

- (a) Regulatory framework
  - (i) As stated above, a sample of three central banks may not be representative of comparable institutions: it is not clear from these examples that there is a "growing trend for regulatory bodies to be subject to specific legislation governing their operations, including their powers and functions."
  - (ii) As the question points out, the powers, the functions and responsibilities of the MA are already clearly laid out in legislation.

The GSC is not aware of any operational or governance difficulties arising from the fact that these powers, functions and responsibilities are set out in different ordinances. The current arrangements have worked well for a number of years. Whether or not to introduce new legislation is a matter for the Government, but the GSC sees no great advantage to be gained from a single ordinance.

(b) Funding mechanism

- (i) The administrative costs of the HKMA are charged to the Exchange Fund in accordance with the Exchange Fund Ordinance. This was made clear during the second reading of the Exchange Fund (Amendment) Bill 1992. The then Secretary for Monetary Affairs said that "The staff and operating costs of the Authority would be charged directly to the Exchange Fund instead of to the general revenue, thus taking the Authority outside the resource allocation constraints applicable to other parts of government"<sup>1</sup>. This reflects the principle that central banking institutions should have, and be seen to have, resource independence, which cannot be separated from operational independence. It is noteworthy that the funding mechanisms for the central banks described in the report all give those institutions a large measure of budgetary independence.
- (ii) The GSC does not agree with Members' suggestion that expenditure not related to the management of the Exchange Fund should be treated separately and subject to the resource allocation mechanism applicable to other government departments. All of the functions of the HKMA fall within the purposes of the Fund as defined in the Exchange Fund Ordinance, which specifically provides that the costs of those functions should be charged to the Fund. Making any of the functions of the HKMA subject to the resource allocation process applicable to other government departments would contravene the widely accepted principles of operational and resource independence for central banks.
- (iii) The GSC agrees that transparency should be improved wherever possible without affecting the proper and efficient operations of the HKMA, and keeps the arrangements for disclosure of the HKMA's budget and other issues related to transparency under continual review.
- (iv) The role and functions of the Securities and Futures Commission (SFC) are different from those of the HKMA. The SFC is required

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<sup>1</sup> Hansard for 4 November 1992

by legislation to lay its budget before the Legislative Council. Although this is not the case for the HKMA, its budget is included in its Annual Report which is published usually in April and presented to the Legislative Council Panel on Financial Affairs in May each year. While the Annual Report obviously relates to the previous year, the budget is for the current year. This practice will continue. The GSC believes that the current level of disclosure of its administrative budget strikes an appropriate balance between the need for transparency and accountability on the one hand, and upholding the principle of resource and operational independence on the other.

(c) Remuneration of senior executives

- (i) & (ii) The GSC notes the comment that the remuneration of the CE/HKMA is the highest among the heads of the bodies covered by the report. The GSC also notes, however, that the remunerations of the heads of other central banks are not always readily available; for example, that of the head of the MAS was not included in the report, although the report states that MAS bases its remuneration on levels in the financial sector. When the HKMA was established in 1993, a conscious decision was made that it should recruit staff on different terms from those of the civil service. This intention was also made known to the Legislative Council during the second reading of the Exchange Fund (Amendment) Bill 1992. The HKMA now recruits the great majority of its staff from the private sector and pay levels are set with a view to recruiting and retaining suitable staff. The GSC believes that it is essential to attract the best qualified candidate, and that salaries must be comparable to and competitive with those offered in the financial sector. This applies to the post of CE/HKMA as to other ranks.

Yours sincerely,



(Marvin Cheung)  
Chairman, Governance Sub-Committee  
of the Exchange Fund Advisory Committee