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Panel on Financial Affairs

**Minutes of special meeting
held on Monday, 28 April 2008 at 8:30 am
in the Chamber of the Legislative Council Building**

Members present :
Hon CHAN Kam-lam, SBS, JP (Chairman)
Hon Ronny TONG Ka-wah, SC (Deputy Chairman)
Hon James TIEN Pei-chun, GBS, JP
Hon Albert HO Chun-yan
Ir Dr Hon Raymond HO Chung-tai, SBS, S.B.St.J., JP
Dr Hon David LI Kwok-po, GBM, GBS, JP
Hon Bernard CHAN, GBS, JP
Hon SIN Chung-kai, SBS, JP
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, SBS, 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

Member absent :
Hon James TO Kun-sun

Public officers attending :
Agenda Item I

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

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

Mr Y K CHOI, JP
Deputy Chief Executive (Banking)
Hong Kong Monetary Authority

Mr Eddie YUE, JP
Deputy Chief Executive (Monetary)
Hong Kong Monetary Authority

Agenda Item II

Professor K C CHAN, SBS, JP
Secretary for Financial Services and the Treasury

Miss Clara CHAN
Principal Assistant Secretary for Financial Services and the Treasury (Financial Services) (Acting)

Clerk in attendance: Miss Polly YEUNG
Chief Council Secretary (1)5

Staff in attendance: Ms Annette LAM
Senior Council Secretary (1)3

Ms Rosalind MA
Senior Council Secretary (1)8

Ms Sharon CHAN
Legislative Assistant (1)8

Action

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

(LC Paper No. CB(1)1332/07-08(01) — Paper provided by the Hong Kong Monetary Authority

LC Paper No. CB(1)1304/07-08 — Hong Kong Monetary Authority Annual Report 2007

LC Paper No. CB(1)1393/07-08(01) — Speaking note of Mr Joseph YAM, Chief Executive of the Hong Kong Monetary Authority (tabled at the meeting and issued to members on 28 April 2008))

Briefing by the Hong Kong Monetary Authority

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. The salient points in his presentation were summarized below:

(a) On credit market turmoil, recent developments in financial markets showed some signs of improvement but credit markets had not yet returned to normal. This could be seen from the continued injection of large amounts of liquidity into the market by the US Federal Reserves System; stagnant securitization market; tight interbank market and the US property market trending down, creating pressure on financial institutions. Given the close link between the credit market and the economic condition, there would be some more time to go before an overall improvement could be seen.

(b) Various reform measures to tackle the structural problems in the medium and the long terms had been proposed by the Financial Stability Forum. HKMA, as a member of the Forum, supported its recommendations which covered five areas: strengthened prudential oversight of capital, liquidity and risk management, enhancing transparency and valuation, changes in the role and uses of credit ratings, strengthening the authorities' responsiveness to risks, and robust arrangements for dealing with stress in the financial system. HKMA maintained good communication with other regulatory bodies through the Financial Stability Committee of the Hong Kong Special Administrative Region Government to implement the recommendations.

(c) On currency stability, the strong-side pressure on Hong Kong dollar (HK dollar) emerged in mid-March amid the rapid depreciation of the US dollar, the continued appreciation of Renminbi (RMB), the expected narrowing of the interest rate gap between the HK dollar and the US dollar, and concerns about inflationary pressure. HKMA did not carry out any market operations during the first three months of 2008 as the exchange rate of the HK dollar remained within the Convertibility Zone. The Aggregate Balance remained stable at slightly below $5 billion after the tap issue of Exchange Fund (EF) Bills in January 2008. The short-term HK dollar interbank interest rates remained generally stable. The discount of the 24-month forward exchange rate from the spot exchange rate had widened from 805 pips in late January 2008 to 1 074 pips in April 2008. Nevertheless, there had been some unwinding of the speculative position in the forward foreign exchange market as a result of the growing interest rate arbitrage activities due to confidence in the Link Exchange Rate (LER) System.

(d) Regarding inflation in Hong Kong, the year-on-year headline inflation rate increased to 6.3% in February 2008. Rising inflation was a global phenomenon, in part due to higher crude oil and food prices. Being an externally oriented economy, inflation in Hong Kong would inevitably follow the global trend. A study by the HKMA showed that exchange rate did not play a significant role in driving domestic inflation. Key drivers of inflation in Hong Kong were rising rent, increasing domestic demand and low unemployment rate. While strong labour productivity growth had kept the change in unit labour cost modest in the past years, thus resulting in limited inflationary pressure arising from wage increases, the downward trend in unit labour cost had started to reverse recently with the strong and sustained economic recovery and the persistent fall in unemployment rate over the past year or so. The recent economic developments of the two major trading partners of Hong Kong, i.e. the possibility of a recession in the US and macro-adjustments in the Mainland would help to reduce inflationary pressure in Hong Kong.

(e) On banking sector performance, the average consolidated capital-adequacy ratio of banks was 13.4% as at end 2007. The US sub-prime crisis did not have any systemic impact on the Hong Kong banking sector and the banking system remained robust and healthy. One of the lessons of the US sub-prime crisis was that market liquidity could dry up quickly. HKMA had asked local banks to review and enhance, where appropriate, their liquidity risk management. On residential mortgage loans, HKMA observed a trend of authorized institutions (AIs) providing such loans with a principal repayment holiday of two to three years. In a bid to prevent risks from spreading, HKMA issued a circular in March 2008 asking AIs to cease the practice. The review of the HKMA's work on banking stability was in good progress. The Consultant, Mr David CARSE, was working on his report which was expected to be finalized in the second quarter of 2008. HKMA would consider a policy response to the Consultant's recommendations when they were available.

(f) Amid lower HK dollar deposit interest rates and market expectation for appreciation of RMB, the amount of RMB deposits in Hong Kong had grown by 72% in the first quarter of 2008. Nevertheless, the recent growth in RMB deposits had had limited impact on the HK dollar and on the Mainland's money supply. Further development of RMB business would provide a robust testing ground for a gradual move towards RMB convertibility for capital account items. HKMA had asked the banking industry to observe strictly all regulations and rules governing the conduct of RMB business and alert their customers of the restrictions as well as the exchange rate risk associated with RMB deposits.

(g) On management of EF, it should be noted that EF was not a pure investment fund and its investment strategy had to be consistent with the statutory objectives of the Fund. Amidst the downward adjustment of the global market, the investment of EF recorded a loss of $14.6 billion in the first quarter of 2008, representing less than 1% of EF's total assets. The investment loss of EF in the first quarter of 2008 did not affect the payment to the Treasury under the new fee arrangement, as the fiscal reserves placed with EF would be paid an annual fee at a fixed rate being the higher of the average annual rate of return of EF's Investment Portfolio in the past six years and the average annual yield of three-year EF Notes of the preceding year. The fixed rate of fee payment to Treasury for 2008 was 9.4% compared to 7% in 2007, reflecting the strong investment performance of EF in 2007. The new fee arrangement enabled the fiscal reserves placed with EF to achieve a more stable and predictable return, which was estimated to be over $40 billion in 2008.

Discussion

Impact of external factors on the economy of Hong Kong

2. Noting that the US government had proposed a number of reform measures to strengthen regulatory oversight of its financial markets and cope with problems associated with the sub-prime crisis, Mr Jeffrey LAM enquired whether these measures would serve any useful reference for Hong Kong. In response, CE/HKMA advised that some of the measures proposed by the US government were broad principles and some were tailor-made to suit their domestic circumstances. For example, the proposal of adopting a target-oriented regulatory approach would have to be examined from the long-term perspective by relevant regulators. In general, the recommendations of the Financial Stability Forum were considered more applicable to the circumstances of Hong Kong.

3. Ms Emily LAU appreciated the detailed analysis on the US sub-prime crisis provided by CE/HKMA. She also supported HKMA's close monitoring to ensure that AIs would observe prudent risk management for maintaining banking stability in Hong Kong. She was however of the view that investors in Hong Kong should stay alert of the risks associated with the monetary and financial developments on the Mainland, given the close ties between the economy of Hong Kong and that of Mainland. She hoped that CE/HKMA could provide some analysis on the investment risks in this respect for the benefit of the investing public.

4. CE/HKMA agreed that the monetary and financial developments on the Mainland would have a significant impact on the economy of Hong Kong, given the close ties between the two economies. CE/HKMA pointed out that he had drawn the attention of the investing public to the fact that the appreciating trend of RMB might not continue incessantly. Hence, those having RMB deposits should keep a careful watch on the exchange rate risk. He advised that as the monetary and financial reforms on the Mainland were underway, HKMA had provided advice on measures to facilitate orderly outflow of capital from the Mainland when it participated in the Focus Group on Financial Services under the Economic Summit on "China's 11th Five Year Plan and the Development of Hong Kong".

5. Mr Jeffrey LAM opined that the appreciation of RMB in the past few months had posed difficulties to small and medium sized enterprises operating on the Mainland. He was concerned whether the uncertainties faced by business operators due to exchange rate volatility could be relieved if the Mainland authorities would allow a one-off appreciation of RMB. Mr LAM was also of the view that this might also help cool down the over-heated Mainland economy.

6. CE/HKMA pointed out that from the monetary management perspective, the Mainland authority would need to manage the expectation for currency appreciation. The impact of RMB appreciation on the Mainland's export was less significant than the impact of economic downturn in the US. Nevertheless, the adjustment of the RMB exchange rate remained a controversial subject as its effect on the Mainland economy was yet to be ascertained although it might be effective in managing expectations in the short-term.

7. Responding to Mr Jeffrey LAM's concern about the impact of the increase in RMB deposits on the economy of Hong Kong, CE/HKMA said that given the small proportion of RMB deposits compared with the total HK dollar deposits in Hong Kong, the increase in RMB deposits would not threaten the status of the HK dollar. The capital outflow would push up the interest rate of HK dollar and free market forces would result in an increase in the demand for HK dollar.

8. Miss TAM Heung-man enquired about the possible measures HKMA might take to help Hong Kong investors and depositors to cope with the risks associated with the continued appreciation of RMB. In response, CE/HKMA advised that HKMA had asked the banking industry to observe the relevant regulations and rules in the conduct of RMB business. He cautioned that the appreciation of RMB might not continue indefinitely as some depositors might have expected. The people of Hong Kong should make their own decisions on the currencies for placing their deposits and savings. HKMA would do its best to apprise Hong Kong investors of the exchange rate risk and other risks associated with RMB deposits.

Maintaining monetary stability

9. Mr CHIM Pui-chung queried whether the LER System launched in 1983 should be maintained under present-day circumstances. He was of the view that the

Government should consider adopting a free-floating exchange rate regime so that the exchange rate of the HK dollar could adequately reflect its value. In this connection, Mr CHIM said that the Administration should make reference to the flexible monetary policy in handling the US dollar peg in Malaysia, instead of adhering to the LER System in a rigid manner.

10. CE/HKMA responded that there had been, from time to time, comments on the propriety of maintaining the LER System. The Administration had conducted internal assessments on the operation of the LER System and had arrived at the same conclusion that the System had been working effectively in the past 25 years to maintain currency stability. It should not therefore be given up lightly. In principle, a fixed or a free floating exchange rate regime had its own merits and shortcomings, particularly for a highly externally oriented economy like Hong Kong. However, the well-established, well-tested fixed exchange rate regime in Hong Kong had demonstrated its benefits to the economy. The US dollar remained the most suitable anchor currency for the HK dollar, given the synchronization in the economic cycles of US and Hong Kong in general over a long period of time.

Inflation in Hong Kong

11. Mr Andrew LEUNG noted that as a result of the peg to the US dollar, there was limited scope for the Government to curb inflation through an interest rate policy. He was concerned about how the public could cope with the rising prices of consumer goods. He also enquired about the impact of changes in unit labour cost on inflation.

12. CE/HKMA explained that inflation was a global phenomenon and was not unique to Hong Kong. While the growth in productivity could help alleviate the impact of inflation, the population in the lower-economic strata would be most hard-hit by inflationary pressure as polarization of the job market had arisen as a result of economic transformation in Hong Kong. As such, relief measures would have to be implemented by the Government to help the grassroot population cope with inflation. As regard the unit labour cost, CE/HKMA advised that this was determined by the relative pace of movements in productivity and labour wages. For illustration, unit labour cost would decrease if productivity increased at a faster rate than the increase in labour payroll. With the persistently falling unemployment rate, however, the growth of labour productivity would lag behind that of labour payroll, resulting in an increase in unit labour cost which would drive up the underlying inflation rate.

13. Miss TAM Heung-man also expressed concern about the impact of the rising inflation rate on the grassroot population. She enquired whether CE/HKMA had provided any views or recommendations to FS on measures to alleviate the hardship faced by these people. Mr Andrew LEUNG expressed similar concern. In reply, CE/HKMA said that he shared the concern of Members and the community about the impact of inflation on people's livelihood. He believed that FS would devise suitable

measures to relieve those most hard-hit by inflation. Where so required, he would offer his views to FS and other government officials.

Supervision of AIs

14. Pointing out that an increasing number of Mainland banks were setting up their business in Hong Kong, Mr Albert HO was concerned about the effective cooperation between HKMA and the relevant Mainland authority in the supervision of these banking institutions. He was concerned that in the light of the differences between the regulatory standards in Hong Kong and on the Mainland, there might be difficulties in carrying out regulatory functions, notably in investigation and enforcement actions against non-compliant cases. He also enquired whether the regulatory differences would give rise to any systemic risks in the banking sector of Hong Kong.

15. In response, CE/HKMA assured members that HKMA had all along maintained close liaison and cooperation with the Mainland authorities to ensure effective supervision of Hong Kong-based AIs operating on the Mainland and Mainland-based banking institutions operating in Hong Kong. No major problems had been encountered by the regulators in their course of work so far. While differences did exist in the regulatory frameworks in Hong Kong and on the Mainland, these could be sorted out through cooperation and dialogue between Hong Kong and Mainland regulators. He also pointed out that the differences in regulatory standards were also an impetus for reforms in the Mainland.

16. As to Mr Albert HO's concern about systemic risk, CE/HKMA advised that HKMA attached great importance to risk management by AIs and adopted a risk-based approach in its banking supervision. The Deputy Chief Executive (Banking) of HKMA (DCE(B)/HKMA) added that banking institutions, regardless of whether from the Mainland or overseas, were required to comply with stringent requirements and standards in areas such as capital adequacy before they could become AIs. Currently, Mainland-based banks which had set up their offices in Hong Kong were subject to Hong Kong laws and under the supervision of HKMA.

17. The Chairman expressed concern about the trend of AIs providing residential mortgage loans with a principal repayment holiday of two to three years. Noting that HKMA had taken actions to ask AIs to cease the practice, the Chairman enquired whether AIs had engaged in such higher risks business as a result of keen competition in the banking sector. He questioned whether the practices of AIs in providing mortgage loans had given rise to any regulatory concern.

18. CE/HKMA said that in the face of keen competition, individual AIs would inevitably adopt more innovative and proactive strategies in their loan business. As the banking sector supervisor, HKMA would monitor the development closely and take necessary regulatory actions where appropriate. He pointed out that AIs had ceased the practice of providing principal repayment holiday for residential mortgage loans upon the advice of HKMA in March 2008. HKMA agreed that

financial innovation should be encouraged for the development of the banking industry and facilitation of capital intermediation. However, regulatory concern would be triggered where such innovation resulted in twisted incentives for investment and brought about systemic risks to the banking system. Under such circumstances, HKMA would need to take prompt action to prevent the risk from spreading.

19. Mr Andrew LEUNG was concerned about the risks involved in structured investment or derivative products such as accumulator contracts. Noting that some of these products were offered to bank customers by AIs under the supervision of HKMA, Mr LEUNG questioned the role of HKMA and the Securities and Futures Commission (SFC) in regulating new structured investment products. The Chairman expressed similar concern. He noted with concern that under the existing regulatory mechanism, structured investment or derivative products sold to investors through private banking services might fall outside the regulatory scope of SFC or HKMA. The Chairman questioned whether there were loopholes in the current regulation of structured investment products, thus putting the interests of investors at risk.

20. In response, DCE(B)/HKMA advised that HKMA worked closely with SFC on the supervision of the securities business of AIs. HKMA performed its role in the supervision of AIs' practices in the sale of securities, such as disclosure of risks to customers while SFC regulated the issuance of structured investment or derivative products. DCE(B)/HKMA pointed out that under the current regulatory requirements, certain structured products sold to professional investors were exempted from the regulation of SFC. In this connection, CE/HKMA added that investors with a large amount of capital for investment might not be aware of the risks involved in the investment of highly structured financial products. He informed members that SFC had provided commentaries on newly developed financial products as part of its investor education. Consideration could be given to stepping up efforts in this regard such as by encouraging more objective analyses on investment products.

21. Mr SIN Chung-kai pointed out that as far as he knew, banks normally had followed a stringent process in identifying "professional investors" as targets for their private banking services. He enquired whether HKMA had conducted random and/or regular examinations on whether banks had duly observed the stringent process in conducting their investment advisory services.

22. In response, DCE(B)/HKMA advised that specialist teams of HKMA carried out on-site examinations of risk management control in specific areas. Examinations of the securities business of AIs was one of the areas covered and the practices of AIs in the sale of the investment products as well as the identification of customers for the investment advisory services would be examined. Responding to Mr SIN Chung-kai's further enquiry on whether HKMA would contact the bank customers to verify the findings of its examinations, DCE(B)/HKMA said that HKMA would act on complaints of bank customers. He also took note of Mr SIN's suggestion that

HKMA should proactively conduct random checking with bank customers on how AIs promoted their securities business.

23. Mr Albert HO was concerned that in the case of many structured investment products, the bank was acting as the counterparty of the position taken by the investor, thus giving rise to conflict of interests. A bank's vested interest might result in an under-estimation or incomplete disclosure of the investment risks of the products to bank customers. He requested HKMA to provide written information, where practicable, on conflict of interests arising between banks and their customers, if any.

24. DCE(B)/HKMA advised that generally speaking, most AIs only acted as agent in the sale of the investment products under which conflict of interest would unlikely arise. However, in the event that an AI acted as the counterparty of the position taken by the investor, concern about conflict of interests might arise. CE/HKMA pointed out that SFC had issued guidelines on the sale of investment or derivative products requiring intermediaries to advise their clients of the risks involved in the products. Intermediaries who did not disclose the risks to their clients in a proper manner would be in breach of such guidelines.

25. Mr Abraham SHEK pointed out that apart from the concern about conflict of interests, the question of whether the intermediaries owed a fiduciary duty to their customers should also be examined. Mr James TIEN was of the view that while banks or other securities intermediaries might be involved in taking positions in their investment activities, individual investors would be at liberty to decide on whether to buy or sell any structured investment or derivative products.

26. The Chairman was of the view that SFC and HKMA should step up efforts in enhancing the knowledge of investors of different types of structured investment or derivative products and their awareness of the associated risks. In view of members' concern about these products, the Chairman opined that the Panel could invite the Administration, HKMA and SFC for further discussion of the subject at another Panel meeting.

Management of the Exchange Fund

27. Referring to Chart 42 of the powerpoint presentation material, Ms Emily LAU queried why in the first quarter of 2008, the accumulated surplus of EF had decreased by $33.4 billion while the investment loss was only $14.6 billion. In response, CE/HKMA explained that under the new fee arrangement with the Treasury, EF had to make a fixed fee payment of $11.8 billion to the Treasury in the first quarter of 2008 despite the investment loss. This fee payment, together with the investment loss and other investment expenses, resulted in a reduction of $33.4 billion in the accumulated surplus of EF. Ms LAU opined that HKMA should provide additional information in the form of explanatory notes in future presentation of the abridged balance sheet of EF to facilitate understanding. CE/HKMA noted Ms LAU's view.

HKMA

28. Miss TAM Heung-man enquired whether HKMA would make reference to the strategy of the Mainland in the investment of its foreign reserves to buy foreign assets in overseas markets in order to achieve a higher investment return on the accumulated surplus of EF. In reply, CE/HKMA advised that he was open-minded to the possible investment of EF. He however pointed out that extra care should be exercised in investment under the volatile monetary and financial conditions of the global markets.

29. Noting from Chart 41 of the powerpoint presentation material that the loss on Hong Kong equities amounted to $30 billion, which was much higher than the loss incurred on other equities for the first quarter of 2008, Mr Ronny TONG was concerned whether the investment of EF in Hong Kong equities had been too aggressive during this period and whether HKMA would review the investment strategy of EF in this regard.

30. CE/HKMA advised that the investment portfolio of EF comprised investment in both the equities and the bond markets so as to balance the risks and preserve the value and long-term purchasing power of the assets of the EF. Taking into account the returns from other investments such as bonds, the total investment loss of EF was only $14.6 billion in the first quarter of 2008 (accounting for less than 1% of the total assets of EF). The investment performance of EF during this period of volatilities was considered acceptable. He nevertheless pointed out that the investment in Hong Kong equities was subject to certain constraint such as the undertaking by the FS for the EF to hold the equities as long-term investments. Improvements had been seen in the investment performance of EF in April 2008 and it was expected that the investment return for April 2008 could more or less cover the loss in the first three months of 2008.

31. Mr CHIM Pui-chung opined that in addition to looking for investment with higher return, HKMA might consider utilizing the substantial surplus of EF for capital investment in infrastructure projects such as the Hong Kong-Zhuhai-Macao Bridge so that the community at large could benefit from the expeditious delivery of these projects. Ms Emily LAU expressed similar view. She added that the large amount of funds available in the accumulated surplus of EF, together with the fiscal reserves, should be utilized properly for the economic development of Hong Kong as well as for helping the needy.

32. In reply, CE/HKMA advised that the investment of EF was guided by the investment benchmark laid down by the Exchange Fund Advisory Committee (EFAC) to achieve investment objectives including (a) to preserve capital; (b) to ensure that the entire Monetary Base at all times would be fully backed by highly liquid US dollar-denominated securities; (c) to ensure that sufficient liquidity would be available for the purposes of maintaining monetary and financial stability; and (d)

subject to (a) to (c), to achieve an investment return that would preserve the long-term purchasing power of the Fund. He cautioned that long-term capital investment in infrastructure projects might not be consistent with the objective of ensuring liquidity and might also give rise to concerns about conflict of interests.

Remuneration and staff turnover in HKMA

33. Referring to the information on remuneration packages of senior staff of HKMA provided in HKMA's Annual Report 2007, Ms Emily LAU noted with concerned the high remuneration levels of CE/HKMA and the DCEs. She pointed out that a comparison provided in the Financial Times earlier had revealed that the remuneration package of CE/HKMA was much higher than those of the heads of other central banks. Ms LAU also noted that HKMA was facing the problem of high staff turnover and there were over 30 vacancies in the some 600 establishment of HKMA in 2007. She asked whether HKMA had plans to adjust the pay packages to tackle the problem of high staff turnover.

34. In reply, CE/HKMA advised that he was not in a position to comment on his own remuneration package, which was not a matter for him to decide. He nevertheless pointed out that the existing policy to pitch the remuneration of HKMA staff to the pay trends and pay levels in the financial sector had been established back in the 1990s when HKMA was established. The remuneration packages of HKMA staff were worked out in accordance with its remuneration policy, so that HKMA could compete with the financial sector for high-calibre personnel. CE/HKMA took the opportunity to highlight that HKMA was in fact facing an acute staff turnover and as a result, serving staff had to work under very heavy pressure, in particular during recent market volatilities.

II. The appointment and tenure of office of the Monetary Authority

(LC Paper No. CB(1)1332/07-08(02)	—	Administration's paper on the appointment and tenure of office of the Monetary Authority
LC Paper No. CB(1)1332/07-08(03)	—	Section 5A "Appointment of Monetary Authority" of the Exchange Fund Ordinance (Cap.66)
LC Paper No. FS15/07-08	—	Paper on appointment and tenure of office of the Monetary Authority in Hong Kong and the heads of central banks in selected places prepared by the Research and Library Services Division

LC Paper Nos. CB(1)1149/07-08(01) to (03) — Three press articles on the remuneration levels of central bankers of different jurisdictions)

The appointment, tenure of office and accountability of the Monetary Authority

35. Mr Ronny TONG deplored the absence of a fixed tenure for the Monetary Authority (MA). He noted that while the heads of the central banks of some major overseas economies were appointed for a fixed term, the MA was appointed by the Financial Secretary (FS) on such terms and conditions as he thought fit. The specific terms of appointment however were not known.

36. Ms Emily LAU shared a similar view. She noted that unlike the heads of central banks of major overseas economies including the United States, the United Kingdom, the European Union, and Australia who were subject to a fixed term of office ranging from four to eight years, MA had no specified tenure. She also referred to press reports that the incumbent MA, Mr Joseph YAM, enjoyed an annual remuneration package close to $10 million, topping the world's best-paid central bankers and was more than four times that of the Chairman of the United States Federal Reserve. She urged the Administration to put in place an appointment mechanism which was in line with best international practice in order that Hong Kong's financial systems could interface with those of developed economies.

37. Mr CHIM Pui-chung opined that the public office of MA should be subject to a specified appointment mechanism including a tenure. Citing the 10-year term limit (two consecutive terms of five years each) for the Chief Executive of the Hong Kong Special Administrative Region and the General Secretary of the Chinese Communist Party as an example, he saw no reason why the tenure of MA could be open-ended. He called on the Administration to promulgate the appointment mechanism to enhance transparency and public accountability. Noting that the incumbent MA had been in post for some 15 years since the establishment of the HKMA in 1993 without any indication of the length of his tenure, MR CHIM was concerned that the HKMA might develop into a de facto kingdom, unsupervised and unregulated by the Government.

38. Miss TAM Heung-man expressed a similar concern. Referring to the Government's six-year six-board rule for appointment to various advisory boards and committees, she queried the propriety of an open-ended tenure for the MA. While indicating her appreciation for Mr Joseph YAM's work over the years, Ms TAM considered that the appointment to such top-ranking posts should be subject to a tenure.

39. On the statutory basis for the appointment of the MA, the Secretary for Financial Services and the Treasury (SFST) referred members to section 5A(1) of the Exchange Fund Ordinance (Cap. 66) (EFO) which provided that the FS should appoint a person to be the MA on such terms and conditions as he thought fit. SFST pointed out that this statutory mechanism had been operating well since the

establishment of the HKMA in 1993. In fact, appointment arrangements of central banks' heads differed in different jurisdictions. Given the unique background and circumstances of each jurisdiction, it was normal that no single practice was regarded as the best and universally applicable. While overseas practice might provide a useful reference for Hong Kong, SFST cautioned against a direct comparison between the HKMA and other central banks. He supplemented that the HKMA was tasked to oversee a wide spectrum of financial policy areas including banking supervision, maintenance of currency stability, management of EF, furtherance of the integrity and stability of the banking system and development of Hong Kong's financial infrastructure. The appointment arrangements of the MA, including tenure of office and remuneration, should take into full account the uniqueness of the functions of the HKMA.

40. Regarding members' concern about the HKMA's accountability, SFST reiterated that the HKMA was entrusted with the responsibility of assisting the FS in performing his functions under the EFO and performing such other functions as were assigned by other ordinances or by the FS. In its day-to-day work, the HKMA operated with a high degree of autonomy within the relevant statutory powers conferred upon the MA. Under the EFO, the MA was accountable to the FS, inter alia, for banking supervision, maintenance of currency stability, management of EF, furtherance of the integrity and stability of the banking system and development of Hong Kong's financial infrastructure. The FS, in consultation with EFAC, conducted annual reviews to assess the performance of the MA and the work of the HKMA.

41. In this connection, Mr James TIEN noted that the HKMA had to act in accordance with the monetary objectives set by the Government to maintain currency stability within the framework of the LER System. The investment portfolio of EF was guided by the investment benchmark laid down by the EFAC, and its investment strategy had to be consistent with the statutory objectives of the Fund. On the MA's terms of office, Mr TIEN urged the Administration to review the existing arrangement with reference to the established practice for appointments to the civil service and the Judiciary, as well as the appointment arrangement for the Chief Executive. He considered that the Administration should enhance the transparency of the mechanism for the appointment of MA.

Independence of the Hong Kong Monetary Authority

42. Given that the FS was a political appointee under the Accountability System for Principal Officials, Mr Ronny TONG was concerned that under the existing appointment mechanism for MA, as FS had full discretion in the appointment, dismissal and the tenure of MA, this might create political pressure on the MA at the expense of its autonomous operation. He further cautioned that the integrity of Hong Kong's financial and banking systems might be compromised by political considerations.

43. Mr Albert HO expressed disappointment over the absence of a legal framework for the operation of the HKMA. He was concerned that the FS's unfettered power over the appointment of the MA would make it possible for him to select a person arbitrarily according to his preference. Mr HO stated the Democratic Party's stance that a piece of governing legislation should be introduced stipulating, inter alia, the appointment mechanism, duties, powers, and responsibilities of the MA. Given the pivotal role of the HKMA in maintaining monetary and banking stability, Mr HO emphasized that governance by statute would help safeguard the independent operation of the HKMA and ensure that the formulation of financial policies and strategies would be free from political interference.

44. In this regard, Mr SIN Chung-kai pointed out that unlike the Securities and Futures Commission and the Mandatory Provident Fund Schemes Authority which were governed by relevant ordinances, the HKMA appeared to be the only regulator without a piece of governing legislation. He expressed regret that despite the Democratic Party's call for the establishment of a governance structure by statute since the 1998 financial turmoils, no progress had been made. To reinforce Hong Kong's status as the leading financial centre of the Asia Pacific region, he urged that a proper governance structure backed up by statute and in line with best international practice should be set up for the HKMA as soon as practicable.

45. Ms Emily LAU supported the introduction of governing legislation for the HKMA. Having regard to the practices adopted in overseas jurisdictions, Ms LAU considered that the terms and conditions of appointment and re-appointment of the MA, including the tenure of office and the retirement age etc should be stipulated in the relevant governing legislation.

46. In response, SFST pointed out that the powers, functions and responsibilities of the MA were clearly set out in the EFO, the Banking Ordinance (Cap. 155), the Deposit Protection Scheme Ordinance (Cap.581), the Clearing and Settlement Systems Ordinance (Cap. 584) and other relevant ordinances. He reiterated that the MA was appointed under the statutory mechanism stipulated in the EFO and was responsible for assisting the FS in performing his functions under the EFO and performing such other functions as were assigned by other ordinances or by the FS.

47. As regards members' concern about the FS's unfettered power over the MA's appointment, SFST pointed out that the FS was a principal official appointed under the Accountability System and was accountable to the public, inter alia, for determining the monetary policy objectives and the structure of the monetary system, maintaining the stability and integrity of the financial systems and consolidating Hong Kong's status as an international financial centre. In support of this overall policy framework and under the delegated authority by the FS, the MA was tasked to draw up and implement various measures on banking supervision, maintenance of currency stability, management of EF, furtherance of the integrity and stability of the banking system and development of Hong Kong's financial infrastructure. SFST added that given the pivotal role of the MA, it was necessary for the EFO to allow maximum flexibility for the FS to determine the terms and

conditions for appointment of the MA. SFST highlighted that when exercising his powers to appoint the MA and determine the relevant terms and conditions, the FS would take into account all relevant factors such as the ability, experience and age of the potential candidates, as well as the views of the Governance Sub-committee of the EFAC, LegCo members and the public.

48. On members' concern about the HKMA's independence, SFST pointed out that the HKMA was an integral part of the Hong Kong Special Administrative Region Government. In its day-to-day work, the HKMA operated independently and with a high degree of autonomy within the relevant statutory powers conferred upon the MA. He referred members to the Exchange of Letters between the FS and the MA in 2003 which were in the public domain. The Letters set out the respective functions and responsibilities of the FS and the MA in monetary and financial affairs, as well as the delegation of power from the FS to the MA. SFST reiterated that the current statutory mechanism for appointment of the MA had been operating well since the establishment of the HKMA in 1993. This could be evidenced by the fact that Hong Kong's financial infrastructure had earned international acclaims, including good ratings by major international credit rating agencies, over the years.

III. Any other business

49. There being no other business, the meeting ended at 10:35 am.

Council Business Division 1
Legislative Council Secretariat
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