立法會
Legislative Council

LC Paper No. CB(1)2627/08-09
(These minutes have been seen
by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of special meeting
held on Thursday, 21 May 2009 at 10:45 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 Albert HO Chun-yan Dr Hon David LI Kwok-po, GBM, GBS, JP Hon James TO Kun-sun Dr Hon Philip WONG Yu-hong, GBS Hon Emily LAU Wai-hing, JP Hon Abraham SHEK Lai-him, SBS, JP Hon Vincent FANG kang, SBS, JP Hon Jeffrey LAM Kin-fung, SBS, JP Hon Andrew LEUNG Kwan-yuen, SBS, JP Hon CHIM Pui-chung Hon KAM Nai-wai, MH Hon Starry LEE Wai-king Hon Paul CHAN Mo-po, MH, JP Hon CHAN Kin-por, JP Hon Tanya CHAN Hon Mrs Regina IP LAU Suk-yee, GBS, JP
Members attending :	Hon LAU Kong-wah, JP Hon WONG Yuk-man
Member absent :	Hon WONG Ting-kwong, BBS

Public officers attending	**:**	<u>Agenda item I</u> Mr Joseph YAM, GBS, JP Chief Executive Hong Kong Monetary Authority Mr Peter PANG, JP Deputy Chief Executive (Development) Hong Kong Monetary Authority Mr CHOI Yiu-kwan, JP Deputy Chief Executive (Banking) Hong Kong Monetary Authority Mr Eddie YUE, JP Deputy Chief Executive (Monetary) Hong Kong Monetary Authority <u>Agenda Item II</u> Mr John TSANG, JP Financial Secretary Mr Christopher MUNN, JP Executive Director Corporate Services Department Hong Kong Monetary Authority Mr Freely CHENG Administrative Assistant to Financial Secretary
Attendance by invitation	**:**	<u>Agenda item II</u> Mr Christopher CHENG, GBS, JP Chairman Governance Sub-Committee The Exchange Fund Advisory Committee
Clerk in attendance	**:**	Ms Rosalind MA Chief Council Secretary (1)5

Staff in attendance : Mr Noel SUNG
Senior Council Secretary (1)4

Ms Haley CHEUNG
Legislative Assistant (1)8

Action

I Briefing on the work of the Hong Kong Monetary Authority

(LC Paper No. CB(1)1594/08-09(01)	—	Paper provided by the Hong Kong Monetary Authority (HKMA)
LC Paper No. CB(1)1349/08-09	—	HKMA's Annual Report 2008
LC Paper No. CB(1)1594/08-09(01)	—	Updated version of pages 36, 38 and 60-63 of the paper provided by the Hong Kong Monetary Authority (tabled at the meeting and issued on 22 May 2009)
LC Paper No. CB(1)1684/08-09(01)	—	Speaking note of Mr Joseph YAM, Chief Executive of the Hong Kong Monetary Authority (tabled at the meeting and issued on 22 May 2009))

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 the work of HKMA. Pointing out that this was the last time for him to brief the Panel on the work of HKMA, CE/HKMA extended his heartfelt thanks to the Panel on behalf of HKMA for its past support for and monitoring of the work of HKMA through regular briefings arranged since May 1999. CE/HKMA gave a summary of the changes in the international developments affecting Hong Kong's financial stability since the last briefing in February 2009, which had brought about challenges to the maintenance of Hong Kong's monetary and financial stability from different dimensions. He highlighted the following points in his briefing:

(a) On exchange rate, Hong Kong's monetary policy objective was to maintain the stability of the exchange rate of Hong Kong dollar against the US dollar in accordance with the Linked Exchange Rate (LER) system. Despite recent discussions in the financial markets about the status of the US dollar as the reserve currency and the prospect of renminbi becoming an international currency, appropriate pre-conditions or sound arguments for changing the monetary policy objective or the structure of the monetary system of Hong Kong did not exist and was not likely to exist for the foreseeable future. According to HKMA's research results, the degree of synchronization of the economic cycles of the US and Hong Kong was still higher than that between Hong Kong and the Mainland. Moreover, renminbi was neither a freely convertible nor a reserve currency.

(b) Since the outbreak of the global financial crisis in mid-September 2008, capital had continued to flow into the Hong Kong dollar. Under the LER system, large amounts of capital inflow helped create a very "easy" monetary environment, encouraging lending and effectively implementing a "quantitative easing" policy. Two important aspects of the money market development, namely impact of the persistent inflow of funds into the Hong Kong dollar on asset prices, and the exit from "quantitative easing", were worth noting. Market participants should pay attention to such development and manage their risks properly.

(c) Credit supply was not a problem at the moment as liquidity in the banking sector was plenty and the Government was providing loan guarantee to the small and medium-sized enterprises (SMEs). While the total loans in the banking sector declined in both the last quarter of 2008 and in the first quarter of 2009, this mainly reflected decreases in loan demand such as trade financing, rather than shortage in credit supply.

(d) According to HKMA's stress tests on banks, Hong Kong's banking system remained sound and robust despite the once-in-a-century global financial crisis.. The current non-performing loan ratio of just over 1% was still healthy, compared with the peak of 10.65% at the end of September 1999. However, the recession and the narrowing of interest-rate margins had affected the profitability of banks, whose operating environment would continue to be difficult. The Deposit Protection Board had started a consultation exercise on the review of the Deposit Protection Scheme, including a proposal to expand the scheme coverage from $100,000 to $500,000. HKMA planned to submit the relevant Amendment Bill to the Legislative Council (LegCo) in the first quarter of 2010, with a view to be fully prepared to implement the changes before the expiry of the temporary full deposit guarantee at the end of 2010.

(e) On work relating to the Lehman Brothers incident, HKMA had received 20 960 complaints up to 14 May 2009, most of which had gone through the preliminary assessment process. HKMA aimed to complete investigation of at least 70% of the complaints by the end of March 2010. Up to 13 May 2009, 6 736 cases had resulted, or would likely result, in voluntary settlements between the banks and complainants. While HKMA welcomed voluntary settlements, its investigations into allegations of mis-selling would not be closed simply because of settlements or withdrawals of complaint cases. HKMA would regardless of any terms of settlement reached or withdrawals of complaint cases, continue its investigation into cases where evidence of mis-selling was revealed.

(f) In order to maintain its status as an international financial centre (IFC), Hong Kong needed to continue to attract investors and fund raisers from outside Hong Kong to conduct financial intermediation in Hong Kong. Hong Kong should develop the relationship between its financial system and that on the Mainland under the one-country-two-systems arrangement, so that the two could mutually-assist, complement and interact. With the development of an advanced Renminbi Real-Time Gross Settlement system, Hong Kong was capable of processing different kinds of renminbi transactions, such as banking business, issuance of renminbi bonds or stock trading denominated in renminbi.

(g) On investment and management of the Exchange Fund (EF), EF recorded a loss of $33.5 billion in the first quarter of 2009. With the clear rebounding of the global financial markets since the beginning of the second quarter, EF had recovered the entire amount of the loss in the first quarter as at mid-May 2009. A well established, suitably conservative investment strategy had been put in place to ensure that EF could fulfill its statutory objectives effectively. The rapid increase in Hong Kong's foreign reserves as a result of large capital inflows was worth noting. HKMA had purchased more than US$40 billion between September 2008 and mid-May 2009, drawing Hong Kong's foreign reserves close to US$200 billion. Hong Kong should be prepared for the possibility of reversal of capital flow and the resulting rapid decline in the foreign reserves.

Discussion

Money market and credit supply

2. Mr Andrew LEUNG commended the work of HKMA on measures to alleviate the impact of the global financial crisis on the monetary and banking systems of Hong Kong. Referring to the significant growth of the Hong Kong stock market in the past months, Mr LEUNG expressed concern about the risks of asset bubbles due to the upward pressure on asset prices caused by persistent capital inflow. He sought CE/HKMA's advice on how the investing public should manage their investment risks. Noting that financial markets around the world had clearly rebounded since the beginning of the second quarter of 2009, Mr LEUNG sought CE/HKMA's view on the timing of economic recovery for Hong Kong.

3. CE/HKMA advised that as central banks around the world were creating substantial amounts of money, leading to considerable increases in money supply and funds searching for higher returns, which might distort the supply and demand as well as prices of highly liquid financial assets, up to a point where they no longer reflected economic fundamentals. Investors should pay attention to the development of such a phenomenon and manage their risks properly. On the timing of economic recovery, CE/HKMA advised that while he would not attempt to make any prediction, there were signs of the economic downturn easing off. Nevertheless, in light of the challenges facing the US and the European economies in tiding over the global financial crisis, CE/HKMA said that he personally did not expect a quick economic recovery for Hong Kong and people should be prepared for a longer period of difficult time.

4. Ms Starry LEE was concerned about inflationary pressure resulting from persistent capital inflow and increases in asset prices. She sought CE/HKMA's view as to whether Hong Kong would face high inflation in the near future. In reply, CE/HKMA advised that the exit from "quantitative easing" was not a difficult task for Hong Kong in a technical sense because in implementing "quantitative easing", HKMA bought highly liquid, high quality US-dollar assets, as opposed to problematic financial assets as in the cases of the central banks in the US and Europe. Hence, if HKMA intended to sell the assets that it had bought and lower the Aggregate Balance, the market would be able to absorb these assets. The Government should continue to closely monitor market developments and implement necessary measures to mitigate the inflationary pressure timely.

5. Mr Jeffrey LAM was also concerned about the amount of capital inflow and sought CE/HKMA's view on whether the capital inflow to the stock market would be long-term or short-term investments. In response, CE/HKMA said that given the free flow of capital in Hong Kong's stock market, it would be

difficult to assess whether the investors concerned intended to purchase the equities as long-term or speculative investments. Market participants should exercise prudence in managing the associated investment risks.

6. Mr Andrew LEUNG was concerned that despite the enhancements to the loan guarantee schemes for SMEs introduced by the Government, many SMEs were still having difficulties in securing credits from banks. Mr Jeffrey LAM also enquired as to measures to be taken by HKMA to assist business enterprises in obtaining loans from banks.

7. CE/HKMA appreciated the credit problems faced by business enterprises. He advised that credit supply was not a problem at the moment given the abundance of liquidity in the banking sector and provision of loan guarantees by the Government. CE/HKMA pointed out that banks had to assess the credit risks of loan applications based on the credit profiles of the applicants concerned. In addition to the enhancements introduced to the loan guarantee schemes for SMEs, CE/HKMA believed that the Government would be willing to examine other suggestions to assist SMEs in tiding over the credit problem. HKMA would be prepared to liaise with the banking sector to address issues relating to SMEs lending.

Performance of the banking sector

8. Referring to the lowering deposit interest rates offered by banks, the Deputy Chairman was concerned whether there was real price competition in the banking sector. He enquired about measures to ensure competition in the banking sector to protect customers' interests.

9. CE/HKMA advised that interest rates in the banking sector had been determined by competitive market forces since the deregulation of the interest rate rules years ago. Pointing out the differences in the prime rates offered by different banks, CE/HKMA said that individual banks determined the appropriate interest rates for their business having regard to the market rates and their own funding cost. Nevertheless, under the current low interest rate environment where the interest rates for deposits were close to 0%, it would be understandable that the disparity in the interest rates among banks would be small, which might have given the impression that banks had offered uniform interest rates or reached a consensus in setting interest rates for deposits.

10. Mr James TO was concerned that while the interest rates for bank deposits were on the decline, there had not been a concurrent reduction in the interest rates for credit facilities, e.g. the prime rates. Mr TO questioned whether the interests of bank customers seeking credits would be undermined due to any form of "collaborative price fixing" or "consensus pricing" in the banking sector.

11. CE/HKMA referred to Slide No. 30 of the power-point presentation and pointed out that the net interest margin of retail banks had narrowed from 1.78% in the final quarter of 2008 to 1.62% in the first quarter of 2009. CE/HKMA advised that prime rates were mainly used as reference for mortgage interest rates. Under the difficult and competitive business environment, banks had been offering mortgage loans at a discount to the prime rates. CE/HKMA said that Hong Kong’s banking sector was very competitive.

Hong Kong Mortgage Corporation Limited

12. Mrs Regina IP expressed concern about media reports of significant investment losses incurred from high-risk investments (such as purchasing Korean asset-backed securities) undertaken by the Hong Kong Mortgage Corporation Limited (HKMC). Mrs IP opined that HKMC's involvement in high-risk investments had gone far beyond the objectives of its establishment, i.e. enhancing banking sector stability and promoting wider home ownership in Hong Kong. She doubted whether HKMC had searched for higher-return investments in order to pay the high remuneration of HKMC's staff.

13. In response, CE/HKMA said that as the Deputy Chairman of HKMC, he understood that HKMC had not undertaken any high-risk investments nor incurred losses from investments. The core missions of HKMC included enhancing the stability of the banking sector through the offering of a reliable source of liquidity, promoting wider home ownership and facilitating the growth and development of the debt securities and mortgage-backed securities markets in Hong Kong. HKMC had been operating in a proper manner in fulfilling its missions. The Deputy Chief Executive (Development), HKMA (DCE(D)/HKMA) added that HKMC had managed its investment risk prudently and had been a profitable organization since its establishment. As a rated entity, HKMC was subject to close monitoring by the international credit rating agencies, which had very high regard of HKMC's risk management framework, underpinning the strong triple-A credit ratings they assigned to HKMC. HKMC engaged external consultant to conduct independent assessment of its risk management framework. At the request of Mrs Regina IP, the Administration would liaise with HKMC for provision of information on the remuneration of HKMC staff, the investment strategy of HKMC and its investment returns in the past years, as well as the assessment made by HKMC's consultant on its risk management and credit ratings.

> (*Post-meeting note*: The Administration's written response was circulated to members vide LC Paper No. CB(1)2055/08-09(02) on 26 June 2009.)

Complaints relating to the Lehman Brothers Minibonds

14. Referring to Slide No. 36 of HKMA's power-point presentation, Mr KAM Nai-wai expressed concern that some complainants had declined to provide further information to HKMA because they were not satisfied with the way the investigations were conducted. Mr KAM pointed out that the complainants, who were victims of the Lehman Brothers incident, did not get the necessary respect in the investigation process, as they were questioned like suspects and requested to provide information about personal investments. While HKMA encouraged banks to reach voluntary settlements with the complainants, Mr KAM pointed out that as far as he knew, some settlements contained terms requiring the complainants to withdraw their complaints. He was concerned about the possible legal liability of the complainants concerned if HKMA continued with its investigations into cases of which settlements had been reached.

15. CE/HKMA said that HKMA staff would pay due respect to the complainants in the conduct of investigations, and would only ask them to provide information relevant to the cases. He pointed out that the terms and conditions of the voluntary settlements were agreed between the complainants and the banks concerned and HKMA had no power to intervene in this regard. He stressed that withdrawal of complaints by the complainants did not necessarily mean that HKMA’s investigation into the cases would stop.

Exchange Fund

16. Mr KAM Nai-wai noted with concern the investment losses of $75 billion and $33.5 billion for EF in the year 2008 and the first quarter of 2009 respectively. As CE/HKMA had advised in his briefing that the loss in the first quarter of 2009 had been recovered by mid-May, Mr KAM sought CE/HKMA's forecast on the investment return for EF in 2009. He also enquired about the estimated amount of fee payment to the Treasury in 2009 for the fiscal reserves placed with EF.

17. CE/HKMA advised that it would be hard to forecast the investment returns of EF under an extremely volatile market. The "fixed rate" fee payment arrangement could provide high stability and predictability to the Treasury's share of investment income. This would facilitate the budgetary exercise of the Government as the amount of fee payment calculated on the basis of the "fixed rate" could be included in the annual Estimates of Expenditure.

18. Noting that the sums raised under the Government Bond Programme (GBP) would be placed with EF for investment, Miss Tanya CHAN enquired about the investment strategy and investment arrangement for the sums, e.g. whether separate investment strategy and portfolio would be devised. In

response, CE/HKMA said that the sums raised under GBP would be placed with EF for investment, and a "fixed rate" fee payment, in the same manner as the fee payment applicable to the fiscal reserves, would apply to the sums. CE/HKMA added that while proper accounting arrangements would be made to set out clearly the amount of the sums raised under GBP placed with EF, separate strategy and arrangement for investment of the sums would not be necessary given that the amount would not be substantial compared with the total assets of EF.

Appointment of the new CE/HKMA

19. The Deputy Chairman remarked that it was regrettable that the incumbent CE/HKMA had to step down when Hong Kong was most in need of his experience in facing the challenges of the current economic downturn. The Deputy Chairman asked whether and what advice Mr YAM would like to give to his successor on ways to cope with such challenges, and whether he would also share his advice with the public.

20. Mr James TO expressed similar concern and requested that the incumbent CE/HKMA remained in office until the economy had stabilized and the aftermath of the global financial crisis died down. Mr TO was of the view that this would be in the best interest of the public, in view of the public recognition and credibility of the incumbent CE/HKMA among all senior financial officials in the Government.

21. CE/HKMA said that he would be prepared to offer his views on measures to cope with changes in the economic environment, if asked by the Financial Secretary (FS) to whom he reported. Responding to Mr James TO's further comment on succession planning, CE/HKMA said that efforts had been made to identify and groom a successor for the post of CE/HKMA in the past. Nevertheless, there was nothing he could do to stop someone from seeking greener pastures outside HKMA.

22. Ms Emily LAU was concerned that while HKMA was an integral part of the Government, it had not be subject to the same level of public oversight in the absence of a piece of legislation to provide for its governance arrangement, including the terms and conditions of appointment of its senior executives, and controls on post-termination employment. The annual budget of HKMA was not subject to LegCo's approval like that of other government bureaux/departments. Ms LAU doubted whether the incumbent CE/HKMA had resisted the call for a piece of legislation governing the operations of HKMA, which could improve its transparency and accountability.

23. In response, CE/HKMA advised that the prevailing governance arrangements of HKMA could serve the purposes of providing autonomy while achieving transparency in performing its functions. The arrangement for FS

to appoint a person he thought fit to be the Monetary Authority had been agreed back in the 1990s during the establishment of HKMA. CE/HKMA said that he personally remained open-minded to the idea of providing a specific piece of legislation for the governance arrangements of HKMA. Responding to Miss Tanya CHAN's question on the areas of improvement for HKMA to enhance its accountability and transparency, CE/HKMA said that no system could be flawless and refinements would be required for a system to cope with changes in circumstances over time.

24. Responding to Ms Emily LAU's further concern about the controls on post-termination employment of HKMA staff, CE/HKMA advised that the control regime should allow flexibility for the flow of talents between the private sector and the financial regulator on the one hand, while avoiding conflict of interests in the post-termination employment of HKMA staff on the other. He considered the existing controls on post-termination employment of HKMA staff appropriate. As to Ms LAU's comment on the need for him to avoid taking up employment which might embarrass the Government, CE/HKMA stressed that he had no intention to take up employment in the private sector after his departure from HKMA.

25. While recognizing the valuable contributions of Mr Joseph YAM in his past years of work with HKMA, Mr Albert HO pointed out that there were deficiencies in Mr YAM's work in certain areas or incidents, part of which were related to the deficiencies in the prevailing system. Mr HO believed that as long as an effective and transparent mechanism for the appointment of the new CE/HKMA would be put in place, a suitable candidate could be chosen for the post of CE/HKMA and the work of HKMA should not be affected by the departure of an individual officer. Mr HO was concerned that HKMA had focused on maintaining banking stability in its supervision of banks but did not make adequate efforts to protect the interest of consumers, e.g. in the sale of the Lehman Brothers Minibonds. Mr HO was of the view that the proposed establishment of a financial services ombudsman might not adequately address the concern and might create overlapping of responsibilities with HKMA.

26. CE/HKMA said that his departure would not affect the operations of HKMA. He said that the role of HKMA as a banking supervisor in consumer protection had remained a subject of debate. In the supervision of banks, HKMA endeavored to protect the interests of bank customers through implementing measures to prevent mis-selling of financial products and enforcement actions against substantiated cases of mis-selling.

27. Mr WONG Yuk-man expressed grave concern that the departure of the incumbent CE/HKMA would affect the operations of HKMA, as he had not put in place a reasonable governance system for HKMA to ensure the smooth operation of HKMA when there were changes in the senior management. Mr WONG regretted that the motion moved by a Member belonging to the League

of Social Democrats at the Council meeting on 6 May 2009 demanding a comprehensive reform of HKMA had been negatived, with only a few Members voted for it. Mr WONG was of the view that in the absence of an established system governing the appointment and tenure of office of CE/HKMA, the incumbent CE/HKMA had held the office for a long period of 16 years and his potential successor had seemingly become impatient to wait for his departure. Noting CE/HKMA's remark about his potential successor, Mr WONG questioned whether he referred to Mr Norman CHAN. In reply, CE/HKMA said that he had no comment in this respect.

Co-operation with the Mainland

28. In view of the increasing significance of renminbi in the global financial market, Miss Tanya CHAN enquired about the prospect of issuing renminbi bonds in Hong Kong, such as whether renminbi bonds would be issued under GBP.

29. CE/HKMA agreed that the importance of renminbi as a currency in the international market would increase over time. The prospect of expanding renminbi business in Hong Kong would hinge on the progress of the Mainland's financial reforms, which the Mainland authorities were taking forward in a cautious manner in order to manage the associated risks. Hong Kong as an IFC should prepare itself by enhancing its ability to handle transactions denominated in renminbi effectively. CE/HKMA pointed out that through building the most sophisticated financial infrastructure to support renminbi business, Hong Kong had prepared itself for participation in new areas of business expansion, including the issuance of renminbi bonds in Hong Kong. He advised that while Hong Kong banks operating on the Mainland had already been allowed to issue renminbi bonds in Hong Kong, development of renminbi business would be further enhanced if the Mainland authorities would allow bond issuances to be determined by market forces.

30. Mr Jeffrey LAM enquired about means to develop the "mutually-assisting, complementary and interactive" relationship between the financial systems of Hong Kong and the Mainland. Mr LAM also sought information on details of the pilot scheme for using renminbi for cross-border trade settlements.

31. CE/HKMA advised that at the policy level, the Mainland authorities agreed with the view that the financial systems of the Mainland and Hong Kong should develop a "mutually-assisting, complementary and interactive" relationship. This relationship should be viewed as the optimal relationship between Hong Kong and Shanghai. On the technical front, there were frequent communications between the financial regulators in Hong Kong and the Mainland. On the pilot scheme for cross-border trade settlement, CE/HKMA advised that the scheme would allow the use of renminbi for

cross-border trade settlements in five Mainland cities. The pilot scheme would enable import and export enterprises in the five cities and their business counterparts in Hong Kong and ASEAN economies to settle trade transactions in renminbi outside the Mainland, thereby enabling these enterprises to manage and reduce the risks arising from exchange-rate volatility. As Hong Kong had developed the necessary financial infrastructures for handling trade settlements in major currencies, Hong Kong's import and export enterprises could immediately reap the benefits of doing business with their Mainland counterparts using renminbi as soon as the applicable control measures were announced by the Mainland authorities.

32. Responding to Mr Vincent FANG's enquiry on whether there was an upper limit for trade settlement under the pilot scheme, CE/HKMA said that the amount of cross-border trade settlements would be limited by the quantity of renminbi deposits held by the banks in Hong Kong. HKMA would aim at establishing links between banks in Hong Kong and the Mainland to facilitate their co-operation in providing renminbi services for enterprises in Hong Kong and elsewhere. HKMA would continue to discuss the proposal with the relevant Mainland authorities.

33. Referring to the rapid development of Shanghai as the country's financial centre, such as the new policy allowing listing of overseas enterprises in Shanghai's stock exchange, Ms Starry LEE was worried that Hong Kong's importance as the country's financial centre might decline in the long run. Ms LEE sought CE/HKMA's view in this regard.

34. In response, CE/HKMA said that with the depth and breadth of the Hong Kong stock market and the international recognition it had received, enterprises seeking listing in the Shanghai market could be encouraged to seek listing in Hong Kong as well. Moreover, an interactive relationship between the markets of Shanghai and Hong Kong should be developed in the long run, so that the two markets would become integrated. CE/HKMA pointed out that the existing segregation of the Shanghai and Hong Kong markets was not conducive to their long-term development in view of the imperfect price discovery mechanism.

35. Noting the progress of financial liberalization on the Mainland, notably the plan to develop Shanghai as an IFC, Mr Paul CHAN was concerned about ways to develop a "mutually-assisting, complementary and interactive" relationship between Hong Kong and Shanghai and to achieve integration of the two markets. Mr CHAN was worried that Hong Kong would lose its attractiveness as a listing venue for overseas companies with the rapid development of the Shanghai market.

36. CE/HKMA appreciated Mr CHAN's concern. Pointing out that when examining the development of Hong Kong and Shanghai as financial centres,

the interest of the country should be the priority. The development of a "mutually-assisting, complementary and interactive" relationship between Hong Kong and Shanghai would require consensus and work on the policy, political and technical fronts. While progress had been made on the policy and technical fronts, further efforts would be required on the political front to reach a consensus for the development.

37. Mr Vincent FANG opined that Hong Kong people should not be over-worried about the development of Shanghai as an IFC. Instead, Hong Kong should stay vigilant and promote further development of its financial market and services in order to consolidate its position as an IFC.

II Remuneration policies of the Hong Kong Monetary Authority and remuneration levels of its senior executives

(LC Paper No. CB(1)1594/08-09(02)	—	Administration's paper on remuneration policies of the HKMA and remuneration levels of its senior staff
FS25/08-09	—	Fact sheet on remuneration of senior staff in selected central banks prepared by the Research and Library Services Division of the Legislative Council Secretariat
LC Paper No. CB(1)1595/08-09	—	Background brief on the remuneration policies of the Hong Kong Monetary Authority and the remuneration levels of its senior executives prepared by the Legislative Council Secretariat
LC Paper No. CB(1)1411/08-09(01)	—	Hon CHIM Pui-chung's letter dated 23 April 2009 to the Panel Chairman
LC Paper No. CB(1)1411/08-09(02)	—	Hon Albert CHAN Wai-yip's letter dated 23 April 2009 to the Panel Chairman

LC Paper No. CB(1)1684/08-09(02) — Speaking note of Mr Christopher CHENG, Chairman of Governance Sub-Committee of the Exchange Fund Advisory Committee (Chinese version only) (tabled at the meeting and issued to members on 22 May 2009))

Briefing by the Financial Secretary

38. The Financial Secretary (FS) briefed members on the remuneration policies of the Hong Kong Monetary Authority (HKMA) and the remuneration levels of its senior staff, by highlighting the salient points in the Administration's paper.

Briefing by the Chairman of the Governance Sub-Committee, Exchange Fund Advisory Committee

39. Mr Christopher CHENG, Chairman of the Governance Sub-Committee, Exchange Fund Advisory Committee (GSC) briefed the meeting on the remuneration policies of HKMA and the role of GSC in advising FS on the remuneration and human-resource policies of HKMA.

Discussion

Remuneration policies and remuneration levels of HKMA staff

40. Mr Jeffrey LAM enquired about the mechanism adopted by GSC in reviewing the remuneration levels of the senior staff of HKMA. He asked whether GSC would make reference to the pay levels of heads of central banks and comparable positions in the private sector in this regard. Mr LAM expressed concern about the transparency of the remuneration levels of staff of HKMA.

41. Mr Christopher CHENG of GSC advised that GSC undertook annual review of HKMA pay, taking into account pay surveys conducted by two independent consultants in the Hong Kong financial market with which HKMA competed for staff. As part of the annual review, GSC also assessed the performance of HKMA as a whole during the previous year. Awards of Variable Pay and any adjustments to Fixed Pay took into account pay data provided by the independent consultants, GSC's assessment of the performance of HKMA, the performance of individual staff, and other factors such as the approved target ratio of Variable Pay to Fixed Pay for the respective ranks.

GSC would also consider the performance ratings of senior staff of HKMA provided by the Chief Executive of HKMA (CE/HKMA), in making recommendations to FS.

42. Noting that in the pay surveys, the market trends for award of incentive pay were based on a weighted average for the past three years, Mr Jeffrey LAM enquired about the reason for this. In reply, Mr Christopher CHENG of GSC advised that adopting a three-year weighted-average could avoid large swings in Variable Pay for HKMA staff due to significant adjustments of the incentive pay in the private sector. Mr CHENG said that GSC would consider the propriety and applicability of using the weighted-average when conducting future pay reviews.

43. Mr CHAN Kin-por was of the view that while it was appropriate to benchmark the pay of middle and lower ranking staff of HKMA against median pay for comparable positions in the financial market, such benchmarking might not be applicable to the pay packages of senior executives. Mr CHAN believed that professionals of high calibre in the financial market would be willing to accept the senior appointments with lower pay packages, in view of the chance to serve the community and the exposure of the public office. Mr CHAN asked whether the above-mentioned factors would be taken into consideration in determining the pay packages for the senior executives including the new CE/HKMA.

44. FS advised that as explained in the earlier briefing by the Chairman of GSC, HKMA had established remuneration policies and mechanism for determination and adjustment of pay. He said that the Government maintained an open mind to the determination of pay packages for new appointees to the senior executive positions of HKMA, taking into consideration market trends, findings of surveys by independent consultants and recommendations of GSC.

45. Mr CHIM Pui-chung expressed reservation on the policies of HKMA to benchmark the pay of its staff against that of comparable positions in the private sector. He called on GSC to take into consideration factors such as prestige of the positions when determining the pay packages for senior executives of HKMA. In this connection, he asked GSC to provide information on:

(a) the benchmark adopted in determining the remuneration levels and annual pay adjustments for senior executives of HKMA, in particular the pay level/pay trend statistics which had been used for reference in the 2008 pay review; and

(b) the areas of HKMA's performance which GSC would assess when making recommendations on the annual pay adjustment.

(*Post-meeting note*: GSC's response was circulated to members vide LC Paper No. CB(1)2062/08-09(01) on 26 June 2009.)

46. Pointing out that senior executives of HKMA were public officers whose remuneration was paid out of the public pocket, Mr Albert HO considered the benchmarking of their remuneration against private sector pay inappropriate. It was also unreasonable to provide Variable Pay to HKMA staff as HKMA was not a profit-making corporation nor was it operating on commercial principles. He called on FS to critically examine the existing remuneration policies of HKMA with a view to working out a reasonable and practicable pay structure. Reference should be made to measures adopted by governments overseas in attracting and retaining talents for regulatory bodies. Moreover, Mr HO opined that the budget of HKMA, being part of the public expenditure, should be subject to approval by the Legislative Council (LegCo) in accordance with the Basic Law.

47. FS responded that the existing remuneration policies and mechanism for pay determination for HKMA staff were considered appropriate. He would take heed of members' views in considering the remuneration package for the new CE/HKMA. As to the award of Variable Pay, Executive Director, Corporate Services Department/HKMA (ED(CSD)/HKMA) explained that this would be considered by GSC in the annual pay review, taking into account findings of market pay surveys conducted by two independent consultants, GSC's assessment of the overall performance of HKMA, and the performance of individual staff. As regards HKMA's ability to attract and retain talents, ED(CSD)/HKMA advised that the remuneration system of HKMA was generally effective in attracting the talent required at different levels for the performance of its various functions. Nevertheless, HKMA had been facing the problem of high staff turnover in recent years, notably for staff in some key areas of its works, showing that the remuneration packages might not be sufficiently attractive to retain the needed talents. While the competition for talents from the private sector had reduced with the economic downturn, the strength of HKMA still fell short of 5% of its establishment.

48. Referring to information on the remuneration of senior staff in selected central banks in 2008 provided in the fact sheet prepared by the LegCo Secretariat, Mr CHAN Kin-por noted that the senior staff of HKMA at the executive director level outnumbered that of overseas central banks. He enquired about the reason for HKMA to have 13 officers at the executive director level compared with only four to five at the similar level in overseas central banks.

49. In reply, FS said that given the differences in the organizational set-up and responsibilities of HKMA and the overseas central banks, it might not be possible to make direct comparison of their staffing structure. While he could

not comment on the organizational set-up of overseas central banks, the existing staffing structure of HKMA was the minimum necessary for performance of the functions of HKMA. Mr Christopher CHENG of GSC added that GSC monitored the staffing structure and reviewed the need for adjustments to the establishment of HKMA annually.

Arrangement for the appointment of CE/HKMA

50. The Deputy Chairman questioned whether it was the right time for replacing CE/HKMA, in view of the challenges of the once-in-a-century global financial tsunami. Pointing out that the departure of the incumbent CE/HKMA at this critical time had given rise to public skepticism on the political considerations behind the move, the Deputy Chairman sought FS's response in this regard. Mr James TO echoed the Deputy Chairman's view. Mr TO criticized the Chief Executive and FS for trying to replace CE/HKMA with their favoured person at this juncture at the expense of the interest of the community.

51. FS said that the departure of the incumbent CE/HKMA was a result of natural wastage and did not involve any political consideration. He advised that Hong Kong had a robust financial and banking system, and effective measures had been introduced to mitigate the effects of the global financial crisis. The departure of the incumbent CE/HKMA would not affect the financial and banking stability nor the operation of HKMA. FS stressed that the Government attached importance to competence of the individuals in identifying suitable candidates for appointment of the new CE/HKMA and would never undermine the interest of the community in its decision. Responding to the Deputy Chairman's concern about the reason for not making announcement on the replacement for CE/HKMA at the same time, FS said that the procedures for selection of the new CE/HKMA had yet to be completed. Upon completion of the procedures, public announcement would be made on the details.

52. Ms Starry LEE pointed out that following the announcement of the incumbent CE/HKMA's retirement in October 2009, there was wide public concern about the arrangement for the appointment of the new CE/HKMA, including the transparency and mechanism of the appointment, and the remuneration package for the new CE/HKMA. Ms LEE asked whether FS would take this opportunity to put in place a formal and transparent mechanism for the appointment of CE/HKMA, such as conducting an open recruitment and/or identifying the suitable candidate through a head-hunting agency.

53. FS pointed out that section 5A(1) of the Exchange Fund Ordinance (Cap. 66) provided him with clear powers and responsibilities to appoint the Monetary Authority, i.e. CE/HKMA, and drew up the terms of appointment. He assured members that he would act in a fair and impartial manner according

to the law to ensure that the appointee was fit and proper and that the appointment was in the best interest of Hong Kong. To facilitate his work in the appointment, FS advised that he had earlier invited three highly regarded individuals to recommend suitable candidates to him, i.e. Dr Victor FUNG, Dr Marvin CHEUNG and Sir John BOND. He had also invited Mr Martin TANG, a retired human resources consultant, to assist in the recruitment work. All of them accepted the invitation in their personal capacity. The selection work was in progress and details would be announced upon completion of the appointment procedures. Responding to Ms LEE's further concern about review of the appointment arrangement, FS advised that a review could be undertaken after completion of this first appointment exercise for the post of CE/HKMA.

54. Mr James TO was dissatisfied with the Government's reluctance to improve the transparency and governance of HKMA by stipulating in law the details of arrangement for the appointment, tenure of office and determination of the remuneration package for CE/HKMA. Mr TO queried why FS had appointed a separate three-member team to make recommendations on the appointment of the new CE/HKMA, instead of seeking the advice of GSC, whose functions included making recommendations on the remuneration and human-resource policies of HKMA.

55. In response, FS explained that he had invited the three highly regarded individuals to recommend suitable candidates for the new CE/HKMA in order to avoid any potential conflict of interest. GSC, as part of the advisory structure under HKMA, would also give advice on the terms and conditions of appointment.

56. Mr James TO opined that the three-member team was used as a guise to justify the appointment of a favoured person as the new CE/HKMA. Mr TO requested the Administration to provide in writing the considerations for appointing the team to give advice on suitable candidates, and the possible conflict of interests which might arise if advice was sought from GSC instead.

(*Post-meeting note*: The Administration's response was circulated to members vide LC Paper No. CB(1)1946/08-09(02) on 16 June 2009.)

57. Ms Emily LAU opined that given the secure tenure and prestige of the CE/HKMA post, the remuneration package for the new CE/HKMA should be set at a much lower level. Expressing dissatisfaction with the absence of a fixed tenure of office for CE/HKMA, Ms LAU asked whether GSC had given any advice to FS in this regard.

58. Mr Christopher CHENG of GSC responded that as the advice of GSC to FS was not public information, he was not in a position to disclose this at the meeting.

59. Noting the response of Mr Christopher CHENG, Ms Emily LAU was concerned about the transparency of the existing mechanism for the appointment of CE/HKMA. Ms LAU opined that as an international financial centre, Hong Kong should put in place a transparent and fair mechanism for the appointment of CE/HKMA. She asked FS to respond to public concern about the details of the appointment arrangement for the new CE/HKMA.

60. FS said that he would not comment on market speculations on the appointment arrangement. In fact, the procedures for appointment of the new CE/HKMA were in the final stage, and he would announce the details of the appointment upon completion of the procedures, including the selection procedures, the remuneration package and the control on post-termination employment.

61. In view of the time constraint, Ms Emily LAU requested that the subject be scheduled for further discussion at another meeting so that FS could provide more details on the appointment arrangement, such as the tenure of office, remuneration and the control on post-termination employment for the new CE/HKMA. The Chairman noted the request and said that arrangement would be made for further discussion of the subject, as and when necessary.

> (*Post-meeting note*: At the instruction of the Chairman, a special meeting was scheduled on 18 June 2009 at 11:30 am for discussion of "Arrangement for the appointment of the Monetary Authority". Members were informed of the meeting arrangement vide LC Paper No. CB(1)1840/08-09 on 8 June 2009.)

III Any other business

62. There being no other business, the meeting ended at 1:15 pm.

Council Business Division 1
Legislative Council Secretariat
28 September 2009