

立法會
Legislative Council

LC Paper No. CB(1)73/09-10
(These minutes have been
seen by the Administration)

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Panel on Financial Affairs

Minutes of meeting
held on Monday, 6 July 2009 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 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 WONG Ting-kwong, BBS, 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

Member absent : Hon Mrs Regina IP LAU Suk-ye, GBS, JP

Public officers attending : Agenda item III
Mr John TSANG, JP
Financial Secretary

Mrs Helen CHAN, JP
Government Economist

Mr Freely CHENG
Administrative Assistant to Financial Secretary

Agenda item IV

Mr John LEUNG
Deputy Secretary for
Financial Services and the Treasury (Financial Services) 3

Miss Grace KWOK
Principal Assistant Secretary for
Financial Services and the Treasury (Financial Services) 6

Ms Grace LEUNG
Assistant Secretary for Financial Services and the
Treasury (Financial Services)

Agenda item V

Mr Patrick HO, JP
Deputy Secretary for
Financial Services and the Treasury (Financial Services) 2

Agenda item VI

Ms Jenny CHAN
Principal Assistant Secretary for
Financial Services and the Treasury (Financial Services) 3

Mr Clement CHEUNG, JP
Commissioner of Insurance

Ms Carol HUI
Acting Assistant Commissioner of
Insurance (Policy and Development Division)

Attendance by invitation : Agenda item V

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

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

Agenda item VI

Mr James WONG
Chairman of the Hong Kong Federation of Insurers

Mr Peter TAM
Executive Director of
the Hong Kong Federation of Insurers

Ms Agnes CHOI
Chairman of General Insurance Council of
the Hong Kong Federation of Insurers

Clerk in attendance: Ms Rosalind MA
Chief Council Secretary (1)5

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

Ms Amy LEE
Senior Council Secretary (1)8

Ms Haley CHEUNG
Legislative Assistant (1)8

Action

I Confirmation of minutes of meeting and matters arising

(LC Paper No. CB(1)2092/08-09 —Minutes of special meeting
on 4 May 2009)

The minutes of the meeting held on 4 May 2009 were confirmed.

II Information papers issued since the last meeting

- (LC Paper No. CB(1)1890/08-09 —Hong Kong Mortgage Corporation Limited 2008 Annual Report
- LC Paper No. CB(1)1936/08-09 —Mandatory Provident Fund Schemes Statistical Digest March 2009
- LC Paper No. CB(1)2012/08-09(01) —Hon Mrs Regina IP's letter on recent developments of Lehman Brothers-related issues)

2. Members noted the information papers issued since the last meeting.

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

- (LC Paper No. CB(1)1625/08-09 —First Quarter Economic Report 2009 and the press release
- LC Paper No. CB(1)2095/08-09(01) —Administration's paper on recent situation and near-term outlook for the Hong Kong economy
- LC Paper No. CB(1)2175/08-09(01) —Powerpoint presentation material provided by the Administration (tabled at the meeting and soft copy issued on 6 July 2009))

Briefing by the Administration

3. At the invitation of the Chairman, the Financial Secretary (FS) gave a brief introduction on the recent situation of the Hong Kong economy. With the plunge in external demand resulting from the global recession, Hong Kong's Gross Domestic Product (GDP) contracted sharply by 7.8% in real terms in the first quarter of 2009, which marked the largest decline since the third quarter of 1998. More recently, with the global economy showing signs of stabilization, there had been relative improvements in the performance of both the external and domestic sectors. The Government's efforts to stabilize

the financial system, support enterprises and preserve employment had yielded positive results. As at 26 June 2009, some 9 300 firms benefited from the loan guarantee schemes, helping to secure the jobs of over 170 000 people. Discretionary relief measures announced since 2008 amounted to \$87.6 billion, or 5.2% of GDP. These measures taken together would raise GDP by about 2.0 percentage points in 2009. Unemployment stabilized for the first time after eight consecutive months of increase but pressure on employment would continue to exist before full economic recovery. The path of recovery would still be bumpy, given the difficulties facing the United States (US) and European economies and the uncertainties about impact of the human swine influenza (HSI). The Government would remain vigilant and make timely moves in response to the evolving external situation.

4. At the invitation of the Chairman, the Government Economist (GE) briefed members on the latest developments in the Hong Kong economy and the updated economic forecasts for 2009 as a whole. The salient points highlighted in the presentation were as follows:

- (a) Following the contraction of 2.6% in the fourth quarter of 2008, Hong Kong's GDP registered a sharp year-on-year decline of 7.8% in real terms in the first quarter of 2009. Many other advanced Asian economies such as Singapore (10.1%) and Japan (8.8%) recorded even larger declines in GDP. While there was double-digit contraction in export in the first quarter of 2009, export performance was still better than many other economies in Asia. Domestic demand was also weak in such a difficult and uncertain global economic climate. Private consumption expenditure fell by 5.5% in real terms in the first quarter of 2009.
- (b) Overall investment spending fell by 12.6% in real terms in the first quarter of 2009. Labour market condition worsened during the first quarter of 2009 but the seasonally adjusted unemployment rate stabilized after eight consecutive months of increase, leveling at 5.3% in March to May 2009. Consumer price inflation continued to trend down, with the headline Composite Consumer Price Index (CPI) inflation easing to 1.3% in May 2009.
- (c) In comparison with the 1997-1998 Asian financial crisis, world GDP had contracted much more severely during the current global financial crisis. Hong Kong's export in the first quarter of 2009 recorded the biggest decline since 1954. Nevertheless, the residential property market of Hong Kong fared much better this time, thanks to stronger fundamentals. The labour market was also more resilient than in 1997-1998 with far less job losses.

- (d) In mid-May 2009, the Government forecast the economy to contract by 5.5-6.5% in 2009. The relief measures announced on 26 May 2009 were expected to further boost GDP by 0.5 percentage point, and the overall effect of the Government's several rounds of relief measures would lift GDP by about 2.0 percentage points in 2009. Headline inflation for 2009 as a whole was forecast at 1% in May and the corresponding forecast for the underlying inflation was revised down from 1.5% to 0.9%.

Discussion

Measures to promote employment and assist low-income households

5. The Deputy Chairman requested the Administration to provide unemployment statistics by sectors, in order to identify those sectors which were most hard hit by the financial crisis. He was also concerned about the relief measures to assist the low-income groups and the unemployed.

6. GE said that the severe economic downturn following the global financial crisis had impacted on a wide range of economic sectors, and the lower-skilled segment suffered more job losses. Analyzed by economic sector, the rise in unemployment rate was most visible in the construction sector (mainly decoration and maintenance sub-sector), with a double-digit unemployment rate. The unemployment rates of the trading, logistics and food services sectors were 4.8%, 7% and 9.4% respectively, recording increases in the range of 2.6% to 4% when compared to the level just before the financial crisis. FS pointed out that the unemployment stabilized in the quarter March to May 2009 after eight consecutive months of increase. The Government had introduced a number of counter-cyclical measures to promote employment and economic growth. For example, the speed-up in infrastructure projects would create a large number of jobs for the construction industry in the coming year and the loan guarantee schemes had benefited private enterprises and help to secure the jobs of over 170 000 people.

7. Responding to the Deputy Chairman's further enquiry about measures to assist the trading and logistics sectors, FS advised that the employment in these sectors was inevitably subject to the significant impact of external factors such as the recession in the US and European economies. The Government had spared no efforts in developing new markets and providing a platform for the trading and logistics sectors to capture these new opportunities. The Government had also worked with the relevant Mainland authorities to help Hong Kong enterprises leverage on the opportunities in the Mainland market. Moreover, enterprises in the trading sector had benefited under the loan guarantee schemes introduced by the Government, obtaining loans of about \$7.5 billion and preserving jobs of some 25 000 people. The Government's

overall strategy was to implement targeted relief measures to revive the economy, support the enterprises and preserve jobs.

8. Referring to Annex A of the Administration's paper on the movement of household income, the Deputy Chairman expressed concern about the decline in average monthly household income by 5.4% in real terms in the first quarter of 2009, and the forecast of 1% headline inflation for 2009. The Deputy Chairman reiterated his concern about the difficulties of the low-income households in coping with the current economic downturn and the measures to relief the hardship of these households.

9. GE advised that the sharp year-on-year decline of 7.8% in GDP in the first quarter of 2009 had adverse impact on different strata of the economy. She pointed out that the rise in the number of low-income households in the past decade was mainly the result of the change in population structure with a significant increase in retired elderly households. Referring to Chart 1 of Annex A to the Administration's paper, GE pointed out that along with the strong economic rebound after 2003, the number of unemployed economically active persons living in economically active low-income households had been decreasing from the peak in 2003 up to before the outbreak of the global financial crisis. This indicated that the key to alleviating poverty was to propel economic growth in facilitating employment of the low-income groups.

10. Ms Starry LEE expressed concern about the increase in insolvency cases as a result of the economic downturn, and asked about the number of insolvency cases after the outbreak of the global financial crisis. Ms LEE also enquired about details of the Administration's plan to consult stakeholders on the introduction of corporate rescue procedures, such as the timeframe of consultation.

11. FS undertook to provide the statistics on insolvency cases after the meeting. As for the proposal for introduction of corporate rescue procedures, FS recalled that the relevant legislative proposal had not received public support when it was last put forward in 2001. The Financial Services and the Treasury Bureau had been studying the proposal and would arrange for consultation on the proposed arrangements probably around late 2009.

(Post-meeting note: The number of insolvency cases provided by the Administration was circulated to members vide LC Paper No. CB(1)2362/08-09(01) on 23 July 2009.)

12. Mr Albert HO noted that while the world GDP and Asian exports had suffered from strong blows of the global financial crisis, asset prices and unemployment rates seemed to be less affected. He doubted whether this was merely because of the lag effect of economic downturn on these two figures, or whether the worst time of the financial crisis was already over. Mr HO asked

whether the Government would introduce other relief measures to assist the various sectors and the unemployed. Mr CHIM Pui-chung also expressed concern about the Government's employment policy.

13. FS explained that unemployment was a lagging indicator. Hence, there would still be upward pressure on the labour market even after the economy bottomed out. But the Government would strive to contain the scale of job loss and the pressure on unemployment. Indeed, substantial resources had already been deployed in the several rounds of relief measures to help various sectors tide over the difficulties of the economic downturn and the Government did not see an immediate need for additional relief measures at the present stage. The Government would try its best to preserve jobs and create employment through promoting economic development. GE added that “green shoots” in the Hong Kong economy had continued to emerge lately, with export orders improving, job loss tapering visibly, and local sentiment generally stabilizing. The Government's relief measures had helped the community in coping with the challenges of the crisis and signs of improvements were expected in the second quarter of 2009. Nevertheless, in view of the uncertainties in the economy, the Government would monitor closely the developments in the second half of 2009.

Impact of the global financial crisis on exports and the business sector

14. Noting that Hong Kong had recorded a larger decline in GDP compared with Korea despite a smaller contraction in export, Mr Andrew LEUNG enquired about the reasons for this, other than the support of a stronger domestic demand in Korea. He was concerned about measures to minimize the impact of export on the economic performance of Hong Kong.

15. FS said that Hong Kong had a much higher degree of external orientation than Korea, which explained why the fall in GDP in Hong Kong was more severe. GE added that Hong Kong's exports were two times of GDP, whereas the export of Korea only accounted for about 40% of its GDP. GE pointed out that the extent of decline in Hong Kong's export was expected to narrow down, given the recent rise-back in Mainland's import intake of raw materials in tandem with the rebound in export orders in the Mainland.

16. Mr Jeffrey LAM noted that the world GDP had contracted much more severely during the current financial crisis compared with the Asian Financial Crisis in 1997. While access to credit had improved and export orders were improving, Mr LAM was concerned about the impact of the reduction in demand in the US market on Hong Kong's export sector. In this connection, he asked the Government to consider measures to promote Hong Kong exports, such as through developing new markets and new products.

17. FS said that domestic demand in US was still very weak alongside the doldrums in the financial and housing markets. FS appreciated the importance of promoting product and market development with a view to helping the export sector of Hong Kong. He assured members that the Government would work closely with relevant authorities in this regard. Responding to Mr Jeffrey LAM's further enquiry about the impact of the surge in fuel prices on the overall economy of Hong Kong, FS believed that this would not have any significant impact on the economy as fuel costs constituted about only 1% of CPI in Hong Kong.

18. Mr Andrew LEUNG said that Members supported the Government's decision to develop six knowledge-based industries. He enquired about the immediate measures in this regard. In reply, FS advised that as announced by the Chief Executive earlier in June 2009, the Government would implement measures to promote the development of the six industries, such as reserving sites for private tertiary educational purposes and private hospital development. The Government was formulating various measures in this regard and would update the Legislative Council on the progress probably in the fourth quarter of 2009.

19. Mr Vincent FANG expressed concern about the hardship faced by the business sector after the global financial crisis, and sought information on the latest operating environment of business enterprises. In response, GE advised that according to the findings of weekly surveys on 500 business enterprises, consumer spending had only recorded moderate reduction in May and June 2009. The food services and the retail sectors had obtained loans amounting to about \$300 million and \$2.4 billion respectively through the Government's loan guarantee schemes. The loans had helped preserve about 13 000 jobs or 6% of the jobs in the food services sector, and about 20 000 jobs in the retail sector.

Impact of human swine influenza

20. Pointing out that the HSI pandemic had resulted in reduction in the number of inbound visitors to Hong Kong, Mr Andrew LEUNG was concerned about the impacts on the tourism, entertainment and catering industries. Mr Jeffrey LAM expressed similar concern. They enquired about measures to alleviate the impact and rebuild the confidence of visitors in Hong Kong's anti-pandemic work. Mr LAM opined that the Government should step up publicity about the effectiveness of its anti-pandemic work and consider measures such as providing financial compensation for visitors placed under quarantine in Hong Kong.

21. FS said that the Government was taking appropriate and necessary measures to tackle the current global HSI pandemic. The Government noted the difficulties facing the tourism sector and had introduced relief measures in

this regard. For example, exempting licence fees for the tourism sector and suspending the Travel Industry Compensation Fund levy. The Hong Kong Tourism Board had allocated additional resources for publicity of Hong Kong tours in the Mainland and set aside \$21 million for the travel industry to participate in its overseas promotion activities. The introduction of multiple-entry Individual Visit Scheme endorsement for eligible Shenzhen permanent residents to visit Hong Kong would also help boost the number of inbound visitors. The Government would continue to monitor the development of the pandemic and work in collaboration with the tourism sector to promote the message of "business as usual" in Hong Kong. GE advised that while there was a 13% drop in visitors to Hong Kong in May 2009, the impact on consumption-related sectors had not been very visible so far. But the Government would continue to monitor the situation closely.

22. Mr CHAN Kin-por opined that the tourism sector had suffered a strong blow because of the relatively stringent strategy and management of HSI (in terms of isolation and quarantine) adopted by Hong Kong. He asked whether the Government would review its strategy having regard to overseas practices and impact on relevant trades. Mr Vincent FANG shared Mr CHAN's concern. Mr FANG was concerned about the impact of HSI on domestic demand and the economy of Hong Kong, notably the impact on the tourism, retail and food services sectors.

23. FS advised that the Government had adjusted its strategy and management of HSI taking into consideration data and experience in handling HSI cases in Hong Kong as well as new findings outside Hong Kong. The Government would keep up its efforts in containment work and remain vigilant of possible large scale local transmissions in the coming winter. FS pointed out that the tourism sector was most hard hit by HSI but the pandemic did not have significant impact on the economy as a whole up to now. He reiterated that the Government had devised various measures to assist the tourism sector in this regard. Given the uncertainties in the development of the HSI pandemic, it would be difficult to assess the precise impact on the economy of Hong Kong at the present stage.

Financial and banking services

24. Mr Jeffrey LAM noted the implementation of the pilot scheme for using renminbi for cross-border trade settlements and other liberalization measures announced by the Mainland authorities to facilitate financial cooperation between Hong Kong and the Mainland. He sought FS's view on the benefits of these measures to the economy of Hong Kong in the short and longer terms.

25. FS advised that the pilot scheme would provide flexibility for Hong Kong enterprises to settle trade transactions with their Mainland counterparts outside the Mainland and would provide ample business opportunities for the

banking sector in Hong Kong given the large volume of trade transactions between Hong Kong and Mainland enterprises. FS said that the Government would maintain close liaison with the relevant Mainland authorities for implementation of other measures to facilitate financial cooperation with the Mainland.

26. Mr Jeffrey LAM pointed out that the financial services sector had suffered great decline in the sale of financial products following the global financial crisis. He was concerned about the ways to assist the financial services sector to tide over the difficulties of business contraction.

27. FS said that financial institutions such as banks had focused more on traditional deposit-taking and lending business in light of the decline in the sale of financial products. To facilitate the development of the financial services and the banking sectors, the Government had plans to develop the local bond market through issuance of bonds under the Government Bond Programme. Moreover, the expansion of renminbi business in Hong Kong (such as the issuance of renminbi bonds and cross-border trade settlements in renminbi) would also provide ample business opportunities for the financial services and banking sectors.

28. Mr CHIM Pui-chung opined that the Government should promote the development of financial services in Hong Kong, so as to attract Chinese investors from all over the world to set up business and purchase properties in Hong Kong. Mr CHIM said that Hong Kong's economy would benefit greatly from the development of the financial services sector if Hong Kong could enhance its status as an international financial centre of the nation and become the second hometown of all Chinese investors. FS noted Mr CHIM's view and said that the Government would consider measures to promote the financial services of Hong Kong.

Asset market

29. Ms Starry LEE and Mr WONG Ting-kwong noted with concern the substantial increase in the prices and transactions of stocks and properties in the recent months, which had resulted mainly from abundant capital inflow rather than real economic growth. They were concerned about the formation of asset bubble and the possible adverse impact on the economy of Hong Kong. Mr WONG was also concerned about the possible impact of abrupt capital outflow on the asset market of Hong Kong.

30. FS said that the asset market had been extremely volatile amid the global financial crisis and such volatility was expected to persist in the near future. Investors should be vigilant about the investment risks under market volatility, because the surge in asset prices had not been supported by economic growth in real terms, and the path of recovery for an

externally-oriented economy like Hong Kong would inevitably be subject to external uncertainties. Nevertheless, with the robust and effective financial and banking systems in place, FS assured members that Hong Kong could cope with the large volume of capital inflows and outflows as an international financial centre. The Government would monitor closely the developments in the US and European economies on the possibility of a second wave of the global financial crisis. GE added that the banking system of Hong Kong remained sound and robust amid the global financial crisis, thanks to the prudential lending stance adopted by banks here. She explained that the main risk associated with quantitative easing on a global scale was that sustained low interest rates arising from funds inflow could encourage excessive borrowing and risk-taking behaviour in the asset markets. However, judging from the latest figures up till then, aggregate loans were still lower than a year earlier, and the current loan-to-deposit ratio was also lower than that before the outbreak of the crisis. However, the Government would continue to watch out for the risk of asset market exuberance and from the regulation point of view, the Government would continue to ensure smooth functioning of the stock market and banks' prudential lending stance. Responding to Mr WONG Ting-kwong's further enquiry on exit from quantitative easing, FS advised that exit strategy had to be adopted in a timely manner to avoid resultant inflationary pressure.

31. Mr CHIM Pui-chung considered that the remarks made by the Chief Executive of the Hong Kong Monetary Authority about the possibility of the second wave of the global financial crisis had affected enterprises' access to credit. Mr CHIM sought the view of FS on the timing for the second wave of the crisis. In response, FS advised that given the immense uncertainties in the global economy, notably the severe recessionary forces facing the US and the European economies, it would not be possible to predict with any precision how the global financial crisis would evolve, or the coming of the second wave of the crisis. Responding to Mr CHIM's further enquiry on Hong Kong's performance under the financial crisis as compared with other economies, FS said that while the export performance and GDP of Hong Kong had been less affected by the financial crisis compared with neighbouring Asian economies, the Government would not be complacent and would monitor the economic situation closely.

32. Noting that the risk of asset bubble was not high compared with the situation back in 1997, the Chairman was concerned about the rapid increase in property prices in the recent months despite decline in average monthly household income. He opined that further increase in property prices would give rise to asset bubble and higher costs of business, which might not be conducive to the healthy development of the economy. The Chairman enquired about measures to facilitate the healthy development of the property market. Ms Starry LEE opined that as the lower and middle income families might have difficulties in purchasing homes given the rise in property prices

without corresponding economic growth, the Government should consider ways to assist these families, such as through adjustments in the land supply and revival of the Home Ownership Scheme.

33. In response, FS advised that home purchase affordability of households remained favourable. The Application List system had all along been operating smoothly and effectively in meeting the market demand for land. The Government would closely monitor the impact of the rising property prices on the economy and introduce appropriate measures if and when necessary. GE pointed out that while the average monthly household income had declined by 5.4% in the first quarter of 2009, the average property price had dropped by about 12% compared with last year. In fact, the average mortgage loan repayment for a flat of about 45 square meters only constituted about 35% of a household's monthly income, compared with over 90% back in 1997, and this was also lower than the average in the past 20 years. GE pointed out that Hong Kong's current account remained in sizeable surplus, an indication that households were not spending beyond their means. There was also no sign of "excessive" borrowing. With property prices still 35% lower than 1997 and with home purchase affordability still good when compared to the 20-year average, the property market was still in a much healthier state than in 1997.

34. Mr CHIM Pui-chung questioned the fairness and propriety of the Application List system, as the applicants who had incurred costs in preparing the applications might not be successful in the subsequent auctions. In reply, FS advised that the Government would uphold the existing market-driven Application List system in providing land to meet the housing, business and various needs of Hong Kong, as the system had been operating effectively in maintaining a proper equilibrium in the supply and demand of land. The Government had no plan to alter the existing arrangement.

Inflation

35. Referring to the inflation forecast for 2009, Mr CHAN Kin-por noted that the relief measures announced by the Government on 26 May 2009 would lower the headline inflation in 2009 by 0.5 percentage point. He sought elaboration on how the relief measures had reduced but not increased inflation.

36. FS advised that the Government's several rounds of relief measures would lift GDP by about 2.0 percentage points in 2009, hence the boosting effect on consumption and the economy as a whole would help reduce the impact of global deflation to some extent. The headline inflation was kept down merely because the cost of living on the general public was lowered with the implementation of relief measures. On the other hand, the underlying inflation would be unaffected by the relief measures. GE supplemented that the difference between the headline inflation and the underlying inflation

reflected the effect of the relief measures as the former represented the rate after discounting the effects of the relief measures.

IV Review of the Trustee Ordinance

(LC Paper No. CB(1)2095/08-09(02) —Administration's paper on review of the Trustee Ordinance and related matters

LC Paper No. CB(1)2094/08-09 —Administration's consultation paper on review of the Trustee Ordinance and related matters)

Briefing by the Administration

37. At the invitation of the Chairman, the Deputy Secretary for Financial Services and the Treasury (Financial Services)³ (DS(FS)³) briefed members on the progress regarding the review of the Trustee Ordinance (Cap. 29) (TO), highlighting the merits and the key proposals of the review. As part of the review exercise, the Administration launched a three-month public consultation on the review of TO and related matters on 22 June 2009. The Administration aimed to draw consultation conclusions by the end of 2009, with a view to introducing amendments into the Legislative Council (LegCo) in 2010-2011.

Discussion

38. Pointing out that review of the trust law regime involved highly technical proposals, the Deputy Chairman queried the propriety and effectiveness of launching a public consultation on the review, as the general public would hardly possess the expertise to give comments on the technical amendments. He asked whether the Administration had invited the Law Reform Commission to study the proposals before releasing for public consultation and if not, reasons for not doing so. The Deputy Chairman was also concerned that the interests of beneficiaries might not be equally represented as those of the trustees in the public consultation, as there might not be any particular organization representing the interests of the former but the latter would certainly engage legal experts to formulate submissions to the Administration.

39. DS(FS)³ agreed that the subject of the review was highly technical and consideration had been given to inviting the Law Reform Commission to study the review proposals. Nevertheless, this had not been pursued in light of the advice of the Department of Justice (DoJ) that Hong Kong could leverage the

reform experience in overseas jurisdictions, such as the recent reform of the Trustee Act in the United Kingdom (UK). DS(FS)3 advised that in addition to views sought on a number of concrete proposals, there were a few issues which the Administration had not yet made definitive proposals, of which it would like to hear the views of various stakeholders before forming a view on them. While there might not be particular organizations directly representing the interests of beneficiaries, DS(FS)3 stressed that the Administration would endeavour to gauge views from different key players of trusts, and liaise with the major charitable trusts to seek their views on the proposals.

40. The Deputy Chairman remained concerned about the protection of beneficiaries' interests in the trust law reform. Pointing out the ambiguities in the current trust law regime relating to issues such as the beneficiaries' right to information, the Deputy Chairman considered it inadequate to draw reference to the reform experience in the UK only. He requested the Administration to reconsider inviting the Law Reform Commission to study the reform proposals to ensure protection of beneficiaries' interests and provide a study report for the Administration's reference.

41. DS(FS)3 said that in formulating proposals in the consultation paper, the Administration had also made reference to the reform proposals of other jurisdictions, in particular on areas where no major changes had been made in the UK reform. For example, reference had been made to the comments of the Law Institute of British Columbia of Canada on the proposal of beneficiaries' right to information. Noting the Deputy Chairman's concern, DS(FS)3 said that he would further discuss with DoJ on whether a study by the Law Reform Commission on safeguarding the interests of beneficiaries in the trust law regime would be worth pursuing. He nevertheless pointed out that the study might take time to complete and exceed the scope of the current review.

42. Mr Paul CHAN appreciated the need for a reform of the trust law regime of Hong Kong to amend and modernize TO in order to facilitate the development of Hong Kong as an asset management centre. He shared the Deputy Chairman's concern about the difficulties in collecting views from the perspective of beneficiaries in the public consultation. In this connection, Mr CHAN suggested the Administration proactively invite views from professional bodies such as the accounting and legal professions, and seek their views from the perspective of their clients who were beneficiaries. Views of academics should also be invited on the review proposals.

43. DS(FS)3 responded that in working out the proposals in the consultation paper, the Administration had taken into consideration views of different stakeholders of the trust services industry, as well as views of academics, experts and the legal practitioners. He believed that more views from various sectors would be collected during the current public consultation. At the

request of Mr Paul CHAN, DS(FS)3 agreed to provide a table of comparison between the Administration's proposed trust law reforms and the trust statues of overseas jurisdictions after the meeting.

(Post meeting note: The information provided by the Administration was issued to members vide LC Paper No. CB(1)2394/08-09(01) on 29 July 2009.)

44. Mr WONG Ting-kwong noted that the permissible investments contained in Schedule 2 of TO included debentures, which might include high risk structured products as revealed after the Lehman Brothers Minibonds incident. He asked how the Administration would address the concern about the definition of debentures in the current review.

45. DS(FS)3 referred to footnote 32 of the consultation paper and pointed out that the definition of "debenture" might need to be reviewed to address any concerns that it could include "structured products", and to tie in with the proposals to amend the definition of "debenture" under the Companies Ordinance rewrite exercise. Hence, the definition of "debenture" under Schedule 2 of TO might be amended to narrow down the scope of permissible investments by excluding any "structured products". The Administration would take into account the views of users and trustees on the proposed amendments in this regard. Responding to Mr WONG Ting-kwong's further enquiry on the legislative timetable, DS(FS)3 advised that following the end of the three-month public consultation on 21 September 2009, the Administration would draw up consultation conclusions around end 2009 and brief the Panel on the consultation conclusions afterwards. The Administration would then commence drafting of the legislative amendments with a view to introducing the relevant bill into LegCo in 2010-2011.

V Review of the Mandatory Provident Fund Schemes Compensation Fund

(LC Paper No. CB(1)2095/08-09(03) —Administration/ Mandatory Provident Fund Schemes Authority (MPFA)'s paper on review of the Mandatory Provident Fund Schemes Compensation Fund

LC Paper No. CB(1)2060/08-09 —Background Brief on review of the Mandatory Provident Fund Schemes Compensation Fund prepared by the Legislative Council Secretariat

LC Paper No. CB(1)2175/08-09(02) —Powerpoint presentation material provided by the MPFA (tabled at the meeting and soft copy issued on 6 July 2009))

Briefing by the Mandatory Provident Fund Schemes Authority

46. At the invitation of the Chairman, Mr Darren MCSHANE, Executive Director (Regulation and Policy), Mandatory Provident Fund Schemes Authority (ED(R&P)/MPFA) gave a powerpoint presentation on the results of the review conducted by the MPFA on the optimal level of the Mandatory Provident Fund Schemes Compensation Fund (MPF Compensation Fund). Having regard to the review of local and overseas experience and the relatively uncertain economic and financial environment amid the global financial crisis, the MPFA considered it prudent to retain the current levy rate of 0.03% of the net asset value of the MPF scheme assets. The MPFA would continue to closely monitor market developments and review the optimal level of the MPF Compensation Fund again in 18 to 24 months' time.

47. ED(R&P)/MPFA advised that the MPFA had also taken the opportunity of the review to examine if the scope of the MPF Compensation Fund should be extended to cover default mandatory contributions owed by insolvent employer companies, in light of an earlier suggestion made by a Member. After review, the Administration agreed with the MPFA's recommendation not to extend the scope of the MPF Compensation Fund to cover default mandatory contributions. In addition to the concern that the proposed extension would fundamentally change the objective of the MPF Compensation Fund and the possible need for a higher levy rate, important considerations for the proposed extension included the concern about equity among law-abiding and defaulting employers, possibility of unscrupulous employers abusing the MPF Compensation Fund, and less incentive for employees to report default contributions by their employers. ED(R&P)/MPFA pointed out that the existing MPF legislation had already provided the MPFA with relevant powers to take enforcement actions against default contributions through the civil and criminal routes.

Declaration of interests

48. Mr Andrew LEUNG declared that he was a Non-executive Director of the MPFA. Mr CHAN Kin-por declared that he was a member of the MPF Schemes Advisory Committee.

Discussion

49. Noting that as of 30 April 2009, the net asset value of the MPF Compensation Fund stood at about \$1,200 million and no claim had been made from the fund so far, the Deputy Chairman considered it undesirable that this substantial amount of money would be left idle in the MPF Compensation Fund. In this connection, the Deputy Chairman asked whether the ex-post approach similar to the funding models of compensation funds for pension systems in overseas jurisdictions would be adopted for the MPF Compensation Fund. Referring to the proposal to suspend the collection of levy for the Travel Industry Compensation Fund when the balance of the fund reached \$500 million, the Deputy Chairman said that the MPFA should also consider suspending the collection of levy for the MPF Compensation Fund and resuming only when the fund balance dropped below a set prudent level.

50. ED(R&P)/MPFA responded that the MPFA had examined the feasibility of determining the optimal reserve level of the MPF Compensation Fund upon which collection of levy might cease, and the trigger level upon which collection of levy should be re-activated, by making reference to some objective parameters. Nevertheless, given the relatively uncertain economic and financial environment under the global financial crisis, ED(R&P)/MPFA advised that it might not be opportune to stop building up the MPF Compensation Fund. The MPFA considered that it would be more prudent to retain the current levy rate and review the issue again in 18 to 24 months' time. In the next 18 to 24 months, the MPFA would continue to closely monitor market developments and take into account those developments in working out a mechanism to determine the optimal level of the MPF Compensation Fund with reference to relevant benchmarks. As the MPF Compensation Fund had started with the collection of levy to build up a fund reserve, instead of adopting the ex-post approach, consideration might be given to moving to a hybrid funding approach under which a reasonable fund reserve was built with reference to a pre-set benchmark and post-compensation levy could be charged after any large-scale payment from the fund was made to restore the fund to a benchmark balance.

51. The Deputy Chairman asked whether it would be more cost-effective to provide insurance coverage to protect the MPF scheme members instead of maintaining a compensation fund for the purpose. In response, ED(R&P)/MPFA advised that due to the absence of relevant data from past claim experience for conducting modeling, the premium for taking out insurance for MPF scheme members would likely be on the high side, as

compared with the relatively small amount of levy for the MPF Compensation Fund, which was only around \$19 per year per member.

52. Mr Andrew LEUNG expressed support to the MPFA's review recommendations in general. He was of the view that the MPFA should attach importance to the supervision of approved trustees to minimize the risks of compensation from the MPF Compensation Fund. Pointing out that the MPF Compensation Fund was established for the purpose of compensating scheme members for losses of accrued benefits attributable to misfeasance or illegal conduct committed by the trustees, Mr LEUNG considered it fair to collect levy for the fund from the approved trustees, rather than the scheme members. He suggested that the levy rate of individual trustees could be determined on the basis of credit ratings assigned by the MPFA so that trustees with better ratings would pay a lower rate and vice versa. In light of the difficulties faced by the workforce in general amid the financial turmoil, Mr LEUNG urged the MPFA to consider conducting an earlier review of the optimal level of the MPF Compensation Fund, say in 12 months' time, and examine the options of stopping the collection of levy or reducing the levy rate. In response, ED(R&P)/MPFA took note of Mr LEUNG's views and advised that the MPFA would take these into consideration in the coming review.

53. Mr Albert HO expressed deep regret about the Administration's decision of not acceding to the proposal to extend the scope of the MPF Compensation Fund to cover default mandatory contributions owed by insolvent employer companies. He considered the Administration's arguments against the proposed extension illogical and unacceptable. He pointed out that regardless of the scope of a compensation fund, equity concerns about law-abiding parties subsidizing non-compliant parties would arise and unscrupulous employers abusing the MPF Compensation Fund would be subject to criminal liability. Mr HO further opined that protection of employees' right to the mandatory contributions owed by employers should be enhanced through extending the scope of the MPF Compensation Fund and strongly requested that the Administration reconsider the proposed extension.

54. Deputy Secretary for Financial Services and the Treasury (Financial Services) 2 responded that the MPF Compensation Fund was established for the purpose of compensating scheme members for losses of accrued benefits that were attributable to misfeasance or illegal conduct committed by the approved trustees or other persons concerned with the administration of those schemes. The proposed extension of the scope of the MPF Compensation Fund would fundamentally change the fund objective. He advised that under the existing MPF legislation, scheme members' interests were protected through, for example, empowering the MPFA to take enforcement actions against non-compliant employers, including civil claims to recover outstanding contributions from defaulting employers and criminal prosecutions of the employers concerned. Legislative amendments had also been made in the last

legislative session to enhance the deterrent effect of default contribution against employers by increasing the maximum penalties of the offence. Noting that there were dissenting views from Members when the proposed extension was last discussed, DS(FS) advised that careful consideration should be given before introducing any changes to the existing arrangement of the MPF System, which had been operating smoothly since its implementation.

55. Mr Albert HO maintained his view that the scope of the MPF Compensation Fund should be extended to provide better protection to employees. He criticized the Administration of its conservativeness and rigidity in making improvement to the MPF System by introducing changes to the objective of the MPF Compensation Fund. The Deputy Chairman shared Mr HO's concern and the view that the Administration's arguments were not justified. To facilitate consideration of the proposed extension, the Deputy Chairman requested the Administration/MPFA to provide information on the number of civil claims that the MPFA made in the past few years to recover default contributions and the amount of default contributions involved.

(Post-meeting note: The Administration/MPFA's response was circulated to members vide LC Paper No. CB(1) 2423/08-09(01) on 4 August 2009.)

56. Mr CHAN Kin-por agreed with Mr Albert HO that scheme members should be protected against losses of MPF benefits resulted from default mandatory contributions owed by employers but he did not consider that the protection must be provided through the MPF Compensation Fund. Given the relatively low risk of compensation and the possibility of adopting a hybrid funding approach in the long run, Mr CHAN urged the Administration/the MPFA to stop collecting levy for the MPF Compensation Fund as soon as possible. He opined that the MPFA could minimize the risk of compensation by stepping up its supervisory efforts to ensure compliance and proper conduct of approved trustees. He enquired about the measures in place to monitor the conduct and compliance of the approved trustees.

57. ED(R&P)/MPFA noted members' suggestion to suspend the levy at an earliest possible date and reiterated that the issue would be kept under review in 18 to 24 months' time. As for the conduct of approved trustees, ED(R&P)/MPFA advised that the MPFA maintained close monitoring of their compliance. The fact that no claim had been made to the MPF Compensation Fund so far could in a way demonstrate the effectiveness of the vigorous monitoring work. He said that according to the statutory requirements, trustees were required to submit a range of returns and reports to the MPFA on a regular basis and other information could also be requested by the MPFA on ad hoc basis where necessary. On-site visits to MPF trustees were also conducted by the MPFA from time to time to understand the trustees' mode of operation and identify areas for improvement. To ensure that trustees had put

in place a proper framework to monitor and ensure compliance with their legal obligations and fiduciary duties, the MPFA had also promulgated a set of Compliance Standards for trustees to adopt. Subsequent to the recent financial turmoil, the MPFA had also stepped up its supervisory efforts and required the trustees to provide additional information in relation to their investment portfolio and management accounts and of those institutions, if any, providing financial support to them, in order for the MPFA to assess the potential impact of the financial crisis on their financial soundness and operations.

VI Policyholders' Protection Fund

- (LC Paper No. CB(1)2095/08-09(04) —Administration's paper on proposed framework for the establishment of a policyholders' protection fund in Hong Kong
- LC Paper No. CB(1)2061/08-09 —Background Brief on policyholders' protection fund prepared by the Legislative Council Secretariat
- LC Paper No. CB(1)2175/08-09(03) —Powerpoint presentation material provided by the Administration (tabled at the meeting and soft copy issued on 6 July 2009))

Briefing by the Administration

58. At the invitation of the Chairman, Commissioner of Insurance (CoI) gave a powerpoint presentation on the proposed framework for the establishment of a policyholders' protection fund (PPF) in Hong Kong and the plan for taking forward the proposal. He highlighted the three guiding principles in constructing the proposed PPF and the key parameters to be adopted for the proposed PPF. On the way forward, CoI advised that the Government would commission an actuarial consultancy study to assess the optimal levy rate, target fund size and detailed arrangements for the proposed PPF. The Government aimed to commence the study in early 2010 and proceed in parallel with the ground work for legislative drafting, with a view to putting forward detailed proposals for the proposed PPF to the Panel within the 2009-2010 legislative session.

Discussion

Considerations for the launch of PPF

59. Mr Andrew LEUNG expressed support for the establishment of PPF in principle but was concerned about the detailed arrangements for taking forward the proposal. Mr LEUNG called on the Government to solicit views from the stakeholders, i.e. the insurance industry and the policyholders, in drawing up detailed arrangements for the establishment of PPF so as to facilitate the formulation of feasible and practicable proposals for PPF.

60. CoI recapped that the Government would commission an actuarial consultancy study to assess the optimal levy rate and other detailed arrangements for the proposed PPF. Meanwhile, the Government would engage relevant stakeholder groups, such as the Consumer Council and policyholders, to solicit their views on the broad approach taken and proceed to formulate detailed governance arrangements for the proposed PPF to facilitate legislative drafting. Public views would be invited on the legislative proposals for PPF at a later stage.

61. Mr Andrew LEUNG was of the view that the establishment of a PPF might not be necessary if the Office of the Commissioner of Insurance (OCI) could ensure proper supervision of the insurers and minimize the risk of compensation.

62. CoI advised that experience of overseas jurisdictions had showed that compensation schemes as safety net and effective regulatory framework for the insurance industry were complementary in enhancing market stability and boosting consumer confidence. In this connection, CoI highlighted that problems faced by the American International Assurance Company (Bermuda) Limited in Hong Kong in September 2008 subsequent to the credit risk of its parent company American International Group Inc. had clearly illustrated the importance of a PPF in maintaining consumer confidence. Another example was the recent liquidation of the Anglo Starlite Insurance Company Limited (Anglo Starlite), which demonstrated the efficacy of the Insolvency Fund Scheme administered by the Motor Insurers' Bureau of Hong Kong (MIB) in safeguarding the interest of policyholders.

Mode of funding and rate of levy

63. Mr Jeffrey LAM expressed support for the establishment of PPF in principle to boost customer confidence and maintain market stability. Mr LAM and Mr Andrew LEUNG shared the view that the levy rates for insurers should be determined according to risk ratings assigned by OCI. In response, CoI said that while OCI maintained internal risk ratings of insurers, these were used as references for the determination of appropriate tools and approaches in

the supervision of individual insurers, and not for public disclosure. Disclosure of these ratings might give rise to undue anxieties and their variations over time might not be conducive to market stability. On the other hand, there would be no transparency in the levy rates under PPF if different rates were determined according to internal risk ratings. Responding to Mr Jeffrey LAM's suggestion of capping the levy rate, CoI advised that both percentage and dollar caps had been proposed on the level of compensation under PPF, but not a cap on the levy rate. CoI said that further consideration could be given to the suggestion.

64. Mr Albert HO expressed support for the establishment of PPF. Noting that contributions payable by banks under the Deposit Protection Scheme (DPS) were determined by the supervisory ratings assigned by the Hong Kong Monetary Authority, Mr HO doubted why the levy rate for PPF could not be determined according to the risk ratings of the insurers. In reply, CoI advised that in drawing up the recommendations for the proposed PPF, reference had been made to DPS and overseas practices. The current proposal of applying a standard levy rate was in line with overseas practices for insurance compensation schemes, and was considered prudent and appropriate.

65. Mr Andrew LEUNG opined that it would only be fair to collect levies from the insurers, not the policyholders, as the proposed PPF would provide compensation if an insurer became insolvent. Collecting levies from insurer would also help mitigate the moral hazards of PPF. The Deputy Chairman expressed similar concern and suggested that the Administration consider requesting contributions from insurers to PPF, for example, through mandatory requirements for insurers to set aside part of their profits as contributions or PPF.

66. CoI advised that the proposed arrangement drew reference to similar local and overseas compensation schemes. Such arrangement could ensure transparency and facilitate market competition for the benefits of both the policyholders and insurers. He said that insurers might seek to transfer the cost of contributions to policyholders by increasing the level of premiums if they would be required to pay the levies under PPF.

67. The Deputy Chairman and Mr Andrew LEUNG maintained the view that insurers should be required to make contributions to PPF. The Deputy Chairman believed that keen market competition would drive down the premiums and prevent insurers from transferring the cost of contributions to the policyholders.

68. Pointing out that some insurance policies contained investment-linked components, the Deputy Chairman suggested that premiums related to the investment components be excluded from the calculation of the levy payable under the proposed PPF. In response, CoI advised that consideration had been

given to imposing different levy rates by the nature of insurance policies. Nevertheless, this would require clear delineation of the types of insurance policies and would not be conducive to the design of a simple levy structure to facilitate public understanding of the proposed PPF.

69. Ms Emily LAU said that Members belonging to the Democratic Party supported the proposed PPF in principle. She also supported that the proposed PPF should be established by legislation. To solicit the support of stakeholders to the proposed PPF, Ms LAU called on the Administration to engage them in discussion of the detailed arrangements. She was concerned about the effectiveness of the proposed progressive funding model for PPF.

70. CoI advised that the progressive funding model could enable the setting of a moderate levy rate during the start-up of the proposed PPF and provide an upfront reserve to meet at least part of future commitments. This funding model was considered more appropriate for Hong Kong in enhancing market stability and boosting confidence in the insurance industry.

71. Mr CHAN Kin-por expressed support for the proposed PPF to protect policyholders' interest and to boost confidence to the insurance industry. Noting that time would be required for accumulation of reserve for the proposed PPF, Mr CHAN enquired about the arrangement in the transition when reserve in the fund was insufficient for paying compensation. In response, CoI advised that measures to bridge any funding gap caused by a case of insolvency occurring before the proposed PPF reached its target size would be devised and put forward to the Legislative Council (LegCo) for comments in the detailed proposal for PPF. CoI said that possible options included securing Government loans or private loans with Government guarantee subject to the approval of the LegCo.

Coverage of policyholders and compensation limits

72. Noting the proposed limit of total compensation of \$1 million per policy, Mr Andrew LEUNG was concerned that there might not be adequate protection for corporate policyholders, notably the small and medium-sized enterprises (SMEs). Mr Albert HO also enquired about the percentage of policyholders covered under the proposed compensation limit and how the value of the policy would be determined in this respect.

73. CoI advised that according to the Hong Kong Federation of Insurers (HKFI), which represented majority of the insurers in Hong Kong, about 90% of policyholders would be fully covered if the \$1 million compensation limit was imposed. CoI said that the most common model adopted by overseas jurisdictions was to set both percentage and dollar caps on the level of compensation. While different policies would have different value depending on their nature, for general insurance business the claim amount would

represent the value of the policies. Similar to the compensation coverage provided by the Insolvency Fund Scheme administered by the MIB in handling claims of policies taken out with the Anglo Starlite, the proposed PPF would pay compensation to policyholders with outstanding claims in respect of policies taken out with the insolvent insurers.

74. Ms Emily LAU was concerned about the coverage of corporate policyholders under PPF and enquired about OCI's consideration of the design of the proposed PPF to meet the aspiration of SMEs.

75. CoI advised that various options were being considered for the design of the proposed PPF to meet the aspirations of SMEs. These included prescribing a definition of SMEs for inclusion in PPF, allowing corporate policyholders to opt for inclusion in PPF, and capping the levy rate to prevent corporate policyholders choosing to place their risk offshore to avoid payment of levies. As the above options had pros and cons in implementation, more examination and discussions would have to be conducted in this regard.

Legislative timetable

76. Ms Emily LAU enquired about the legislative timetable for the introduction of the proposed PPF. In reply, CoI advised that the Government aimed to complete the tendering procedures for the actuarial consultancy study within 2009 so as to commence the study in early 2010 and put forward detailed proposals for the proposed PPF to the Panel within the 2009-2010 legislative session. Subject to the support of Panel members, the relevant bill might be introduced into the LegCo in 2011.

77. Mr CHAN Kin-por pointed out that the insurance industry had been hardly hit by the economic downturn and suffered from a significant drop in business. He said that the insurance industry was looking forward to the early introduction of PPF and called on the Administration to advance the legislative timetable with a view to passing the relevant bill within the 2009-2010 legislative session. In reply, CoI said that time would be required for working out the detailed proposals for the PPF in consultation with stakeholders and preparing the draft legislative proposal. CoI assured members that the Administration would endeavour to expedite the legislative exercise as far as practicable.

Premiums of life insurance policies

78. Responding to Mr Jeffrey LAM's enquiry on the feasibility of offering "No Claim Bonus" for life insurance policies similar to those offered under motor insurance, CoI explained that unlike general insurance policies of which annual premiums would be set on the basis of risk assessments and claims experience, life insurance policies sought to provide long term protection and

benefits to the policyholders. The premium for life insurance would be determined on the outset when the policy was taken out, taking into account assessment of risks such as age and health status of the insured.

Protection of policyholders in case of misconduct of insurance intermediaries

79. Noting that the proposed PPF would pay out compensation in the event of insolvency of an insurer, Mr Albert HO was concerned about the protection of policyholders in case of misconduct of insurance intermediaries, such as misappropriation of premiums paid by their clients.

80. CoI responded that a mechanism had been put in place for handling misconduct of insurance intermediaries (about 50 000 of the some 57 000 intermediaries were insurance agents and the remaining were insurance brokers) in the sale of insurance products under the current regulatory framework. CoI and Mr James WONG, Chairman of HKFI, explained that as insurance agents were appointed by insurers, the latter would be responsible for following up complaints on misappropriation of premiums and would arrange to refund the premiums to the complainants concerned should the cases be substantiated. On the other hand, insurance brokers must arrange to take out professional indemnity insurance to cover their clients. CoI added that all insurance intermediaries committing misconduct were subject to disciplinary actions such as suspension or termination of registration.

81. Mr Albert HO was concerned that the public might not be aware of the differences between insurance agents and insurance brokers, notably the differences in the channels for seeking remedies in case of misconduct of these intermediaries. In response, CoI advised that in addition to public education about the services of insurance intermediaries, measures were in place to require insurance brokers to keep premiums in a designated account separate from their own operating capital. The historical pattern indicated that most public complaints were related to misrepresentation and poor quality of service rather than misappropriation of premiums.

VII Any other business

82. There being no other business, the meeting ended at 12:46 pm.