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Panel on Financial Affairs

Minutes of special meeting
held on Friday, 15 November 2013 at 9:00 am
in Conference Room 3 of the Legislative Council Complex

Members present :	Hon Starry LEE Wai-king, JP (Chairman) Hon Christopher CHEUNG Wah-fung, JP (Deputy Chairman) Hon Albert HO Chun-yan Hon James TO Kun-sun Hon CHAN Kam-lam, SBS, JP Hon Abraham SHEK Lai-him, GBS, JP Hon WONG Kwok-hing, BBS, MH Hon Andrew LEUNG Kwan-yuen, GBS, JP Hon WONG Ting-kwong, SBS, JP Hon Ronny TONG Ka-wah, SC Hon CHAN Kin-por, BBS, JP Hon Mrs Regina IP LAU Suk-yee, GBS, JP Hon James TIEN Pei-chun, GBS, JP Hon NG Leung-sing, SBS, JP Hon Kenneth LEUNG Hon Dennis KWOK Hon SIN Chung-kai, SBS, JP
Members attending :	Hon CHAN Yuen-han, SBS, JP Hon TANG Ka-piu
Member absent :	Hon Jeffrey LAM Kin-fung, GBS, JP

Public officers Attending	**:**	Hong Kong Monetary Authority Mr Norman CHAN, GBS, JP Chief Executive Mr Peter PANG, JP Deputy Chief Executive (Development) Mr Eddie YUE, JP Deputy Chief Executive (Monetary) Mr Arthur YUEN, JP Deputy Chief Executive (Banking)
Clerk in attendance	**:**	Ms Connie SZETO Chief Council Secretary (1)4
Staff in attendance	**:**	Mr Angel SHEK Senior Council Secretary (1)4 Ms Sharon CHAN Legislative Assistant (1)4

Action

I Briefing on the work of Hong Kong Monetary Authority

(LC Paper No. CB(1)250/13-14(01) — Paper provided by the Hong Kong Monetary Authority)

At the invitation of the Chairman, the Chief Executive, Hong Kong Monetary Authority ("CE/HKMA"), the Deputy Chief Executive (Development)/HKMA ("DCE(D)/HKMA"), the Deputy Chief Executive (Banking)/HKMA ("DCE(B)/HKMA") and the Deputy Chief Executive (Monetary)/HKMA ("DCE(M)/HKMA") updated members on the work of HKMA through a powerpoint presentation. Topics included assessment of risks to Hong Kong's financial stability, development of financial infrastructure, banking supervision, Hong Kong as an offshore Renminbi ("RMB") centre, and investment performance of the Exchange Fund ("EF").

(*Post-meeting note*: The powerpoint presentation materials (LC Paper No. CB(1)351/13-14(01)) were issued to Members by a Lotus Notes e-mail on 19 November 2013.)

Discussion

Investor and consumer protection

2. Mr WONG Kwok-hing said that he had written to the Chairman in July 2013 expressing concerns about levying of fees by banks on dormant or low-balance accounts without giving prior notice to the clients concerned. He commended HKMA's efforts in lining up 22 retail banks in Hong Kong to sign the Treat Customers Fairly Charter ("TCF Charter") on 28 October 2013, and welcomed the decision of banks to abolish fees on dormant accounts, exempt vulnerable group customers from low-balance account fees, and offer customers the option of bank accounts providing basic services without charging low-balance account fees. Mr WONG sought clarification about whether all the 22 retail banks signing the TCF Charter had abolished or waived such fees on their clients, as well as provided customers with the option of basic-service bank accounts.

3. CE/HKMA said that HKMA exercised caution in the supervision of banks, taking into account various considerations such as interests of the general public as well as the business cost of the banking business. In the light of public concern about fees on dormant/low-balance accounts, HKMA had commenced discussion with retail banks on the matter and the TCF Charter since 2012. DCE(B)/HKMA added that HKMA was keeping a watching brief on the implementation of measures under the TCF Charter by individual banks. Six of the 22 retail banks had already announced on the date of signing the TCF Charter that they would abolish the fees on dormant accounts and exempt all vulnerable group customers from low-balance fees. Since then, a number of the remaining banks had implemented similar measures. At the request of Mr WONG Kwok-hing, DCE(B)/HKMA agreed to provide further information on the progress.

(*Post-meeting note*: HKMA's written response to the request was issued to members vide LC Paper No. CB(1)448/13-14(02) on 3 December 2013.)

4. Noting that some banks had stopped issuing account passbooks to their customers and only provided electronic and phone banking services for checking account transactions and balances, Ms CHAN Yuen-han expressed concern that such measures had created inconvenience to customers, in particular the elderly who were not accustomed to using telephone or electronic

banking devices. DCE(B)/HKMA said that provision of banking services through electronic means was an inevitable trend. HKMA had advised banks that they should implement related measures in a progressive manner with regard to the needs of different groups of customers. It had been observed that some retail banks still offered the option of account passbooks to customers.

5. Mr James TO relayed complaints from some Mainland investors about authorized institutions ("AI") in Hong Kong selling investment products to them with the entire sales process including product explanation, signing of contract and opening of investment account, etc. conducted in the Mainland. While he noted that insurers or insurance intermediaries were prohibited from selling insurance products across the border, he queried whether Hong Kong AIs engaging in the above mentioned activities in the Mainland had breached HKMA's regulations. DCE(B)/HKMA said that in general if a local AI had obtained approval to operate in the Mainland, its intermediaries set up in the Mainland could carry out relevant businesses in the Mainland. Otherwise, the AI could only promote the investment service/product to the Mainland investors through marketing activities but could not offer the service/product to the Mainland investors. DCE(B)/HKMA remarked that the facts and circumstances of each individual case had to be examined in determining whether there was a breach of regulations. He said that members could refer suspected cases for follow-up by HKMA. Noting HKMA's response, Mr TO opined that HKMA should consider issuing relevant circulars to advise or remind AIs on related regulations in this respect.

Quantitative easing in the United States

6. Mr TANG Ka-piu pointed out that US's quantitative easing ("QE") measures had led to inflation in Hong Kong and adversely affected the low-income group. He sought HKMA's views on whether the United States ("US")'s QE tapering would help ease Hong Kong's inflation and alleviate pressure on the Hong Kong working class.

7. CE/HKMA said that inflation was affected by a host of factors, including property prices and rentals, prices on food and fuel, etc. If the US Federal Reserve tapered bond purchases, and increased its interest rates, Hong Kong's interest rates would follow and this would bring about a negative impact on asset prices. CE/HKMA observed that the high demand of fuel and other raw materials from developing economies, especially the BRICS (Brazil, Russia, India, China and South Africa), had pushed up the prices of these materials and subsequently the price of commodity exports from these areas. A reversal of the interest rate trend in the US would have a moderating effect on the growth of these economies and the prices of fuel and other raw materials,

and might help bring down prices of Hong Kong commodities which were largely imported from the Mainland or overseas.

Property market and mortgage lending

8. Mr Albert HO expressed concern about the effectiveness of the latest demand-side management measures in addressing the overheated property market as evidenced by the continued rise in property prices. He was worried that the extremely low interest rate environment and presence of excessive liquidity, coupled with a shortage in flat supply, had fueled speculation in the property market, and the trend would not reverse unless US tapered its quantitative easing and increased the interest rates.

9. Referring to pages 16 and 17 of the powerpoint materials, CE/HKMA said that the local property market had seen some signs of cooling after announcement of the Administration's demand-side management measures in February 2013. Nevertheless, outlook of the property market and movement in prices remained uncertain even with decrease in the number of property transactions recently. Although the prices of large-sized flats had decreased by about 2% in the recent period, the prices of small and medium-sized flats had risen by 2%. While transactions of second-hand flats had stagnated, the sale of first-hand residential properties remained active, in particular with some property developers offering to pay the additional stamp duties imposed by the demand-side management measures. Changes in the US monetary policy would probably impact on the asset prices in Hong Kong but the timing of US's pull-back from QE was uncertain. CE/HKMA further pointed out that the property market had gone through cyclical fluctuations where a period of downward adjustment would be followed by a period of upward growth as property prices were affected by a host of factors, including land and flat supply, interest rate, home purchase affordability and macro-economic conditions, etc. HKMA would monitor the developments and adjust its countercyclical prudential measures in accordance with the property market cycles.

10. Mr SIN Chung-kai noted from page 18 of the powerpoint materials that the growth in mortgage loans had slowed down recently, and enquired whether this was due to increase in liquidity in the hands of home-buyers. Ms CHAN Yuen-han enquired about measures to strengthen mortgage borrowers' ability to withstand interest rate hike and severe adjustment in property prices if US's QE tapering began.

11. CE/HKMA said that HKMA had introduced six rounds of countercyclical prudential measures since October 2009 with the aim to maintain banking stability against possible reversal of the low interest rate

environment by strengthening banks' mortgage underwriting standards, constraining excessive mortgage lending and hence minimizing the potential interest rate shock on mortgage borrowers. He said that mortgage loans had been held in check by the measures as evidenced by the decline in the average loan-to-value ("LTV") ratio for new residential mortgage loans ("RMLs") from 64% in September 2009 to 53% - 55% recently. The fall in number of property transactions in the recent months had also resulted in lower demand for mortgage loans. DCE(B)/HKMA supplemented that, apart from the LTV ratio, HKMA had been monitoring the risks of the property market and mortgage lending to Hong Kong's banking system by making reference to the debt servicing ratio ("DSR") (i.e. the monthly repayment obligations of the borrower as a percentage of monthly income adopted by banks for assessing the repayment capability of mortgage applicants). Currently, the maximum DSR ratio was limited to 50%. The average DSR for new RMLs had decreased to 35% (based on income before tax and including all personal loans) as compared with 41% in August 2010 when the DSR requirement was first tightened. Besides, the stress-test on mortgage applicants' repayment ability by assuming an increase in mortgage rates of at least three percentage points and a stressed DSR cap of 60%, would constrain the repayment amount. DCE(B)/HKMA further said that property mortgage borrowers whose income was derived mainly from outside Hong Kong were subject to more stringent LTV requirements, and the amount of such mortgage loans had remained stable at about 4% of newly drawn-down mortgage loans.

RMB business in Hong Kong

12. Mr CHAN Kin-por observed that, although the loan-to-deposit ratio for Hong Kong dollar was high compared to other currencies, i.e. at about 85%, placement of deposits might shift from the Hong Kong dollar to RMB in view of its more favourable interest rate. He was concerned that this might pose pressure to increase the interest rate for Hong Kong dollar deposits.

13. CE/HKMA advised that the interest rates for Hong Kong dollar deposits were affected by a number of factors. It was observed that the amount of Hong Kong dollar deposits remained stable accounting for about 50% of the total bank deposits. While RMB took up some 10% of the total bank deposits in Hong Kong, there was no sign of marginalization of the Hong Kong dollar.

14. The Chairman and Mr CHAN Kin-por noted that HKMA had put forward proposal to the Central Government for lifting the daily conversion/withdrawal limit of RMB 20,000 on RMB banking per person per day, and enquired when the measure would be implemented. In view of the crucial role of RMB in the future development of financial services in Hong Kong, the Chairman enquired whether there was discussion on other

liberalization measures with a view to enhancing Hong Kong's role as an offshore RMB centre.

15. CE/HKMA observed that the financial services industry in general welcomed early abolition of the daily exchange/withdrawal limit of RMB 20,000, in particular, the measure would be advantageous to promoting RMB-denominated financial products priced above this limit. He said that there had been positive response from the Central Government on the matter and the detailed proposal was under active consideration by the relevant authorities. As regards other initiatives to enhance cross-border RMB circulation, CE/HKMA said that development in this area was still constrained by the absence of full liberalization in the Mainland's capital account and complete mobility of RMB. Nevertheless, the Mainland was stepping up efforts, including introducing a pilot scheme for cross-border RMB lending in Qianhai as promulgated in 2012 to allow companies registered in Qianhai with substantive operations or investments to borrow RMB funds from banks in Hong Kong. He believed that such pilot measures, if implemented successfully, could be extended to other cities/areas of the Mainland. HKMA would continue to work with the local financial services industry in making relevant proposals to the Central Government where appropriate.

Enhancing circulation of coins

16. Mr CHAN Kin-por noted that despite the popular use of Octopus card as a retail payment tool, the total value of coins in circulation had increased in the past five years by about $1 billion to $6.3 billion at present. CE/HKMA said that, although Octopus card payment had enhanced the efficiency of retail transaction, the demand for coins was still high. He noted that some coins were kept by some end-users at home, partly for collection purpose. Whereas tourists also kept coins for collection purpose. To enhance circulation and reduce minting expenditure, HKMA would roll out a coin collection mobile kiosks pilot scheme in mid-2014, where users might exchange coins for banknotes or Octopus card value at various locations throughout Hong Kong on a rotational basis.

17. Mr WONG Ting-kwong opined that HKMA should encourage banks to provide free service for exchanging coins for notes or depositing coins to accounts on a temporary basis so as to facilitate the public to return the coins to banks. He considered this would be more cost effective than recovering the coins from the community through the coin collection mobile kiosks. CE/HKMA and DCE(B)/HKMA said that the suggestion might not be practicable as administrative costs were involved for banks to collect and count the coins. The time required for processing large amount of coins at bank teller counters might also disrupt other banking services to customers. The current

arrangement of retail banks to levy fees for the exchange or deposit of coins when the number of coins exceeded certain threshold was not unjustifiable from a commercial perspective.

18. In response to Mr CHAN Kin-por's enquiry whether the practice of some retail shops refusing to accept small-denomination coins (such as 10-cent, 20-cent and 50-cent) would be illegal, DCE(D)/HKMA said that under the Coinage Ordinance (Cap. 454), coins were legal tender as payment. Nevertheless, there was no statute compelling acceptance of coins in business dealings. It would be a commercial decision of traders whether to accept coins of certain denominations in their transactions with customers.

Linked Exchange Rate system

19. Mr TANG Ka-piu enquired whether HKMA would consider pegging the Hong Kong dollar to RMB instead of the US dollar, in view of weakening of the US dollar and limitation of the Linked Exchange Rate system in tackling inflation. CE/HKMA pointed out that, as a small and open economy, Hong Kong had to handle large-scale inflows and outflows of funds on a daily basis. A monetary system with an "anchor", i.e. currency backed by a major international currency, would enhance confidence in the Hong Kong dollar and support the development of Hong Kong as an international financial centre. While RMB had embarked on internationalization, the pre-conditions for a peg to RMB, namely, a fully liberalized capital account and full capital mobility/convertibility of RMB, were yet to be seen. Moreover, the depth, breadth and liquidity of the RMB investment universe were not yet sufficient for holding the "anchor" currency assets as backing for the Hong Kong dollar. Besides, the economic cycle of the anchor currency should be closely synchronized with that of Hong Kong. However, even with growing trade integration between Hong Kong and the Mainland, Hong Kong's economic cycle was still more influenced by the US than the Mainland.

Performance of the Exchange Fund

20. Mrs Regina IP suggested that HKMA should provide members with information on the investment principal and the rate of investment return from EF's investment, instead of just information on the amount of investment income. CE/HKMA explained that the investment income of $49 billion for EF for the third quarter of 2013 had taken into account the gain/loss on a mark-to-market basis. DCE(M)/HKMA said that EF achieved a return of 4.4% in 2012. It was market practice to compute the rate of investment return yearly given the technicalities involved. Nevertheless, he would consider Mrs IP's suggestions to enhance provision of information in future briefings.

21. Mr James TIEN noted that the investment of EF in both Hong Kong equities and other equities recorded a gain of $73.5 billion altogether in 2012, as compared to a loss of $36.4 billion in 2011, and EF was able to yield about $60 billion to $70 billion on average in the recent years (i.e. a return rate of at least 2% on yearly average). In view of the relatively strong and stable investment return and the total assets of EF at nearly $3,000 billion, Mr TIEN suggested that the Government should transfer the annual investment returns from EF to the Treasury for implementing social welfare, health and housing measures, while maintaining the total assets of EF at the current level. He opined that the sum would serve as additional resources to benefit the community at large, in particular, for improving the livelihood of the vulnerable groups in society.

22. CE/HKMA said that EF was under the control of the Financial Secretary ("FS"). In spite of investment gains in some years, the investment performance of EF did fluctuate with external environment. For instance, the investment market had been very volatile in the first nine months of 2013. The investment return from the stock portfolio had almost made no gain in the first half of the year and picked up only in the third quarter as the stock market rallied. As the timing and impact of the US's exit from QE on the stock market remained uncertain, it would be difficult to predict EF's investment return in the years ahead. CE/HKMA further said that it would be a matter for FS in the management of public finances to decide on the use of EF. Currently, out of the some $2,800 billion total assets of EF, about $700 to $800 billion were placement of fiscal reserves and other government funds. These funds earned a return of 5.6% (or $37.8 billion) for 2012 and 5% for 2013 (i.e. about $27.8 billion for the first nine months of 2013). The sums earned would then form part of the fiscal reserves.

23. Mr Christopher CHEUNG noted that HKMA had recently entered into a joint venture with a United Kingdom-based company to develop an estate project in London. As the project was expected to complete after five years by 2018, he asked about HKMA's assessment of the investment risks in the interim and the estimated rate of return from the property investment.

24. CE/HKMA said that real estate and private equity were among the new asset classes under the Long-term Growth Portfolio of EF for medium and long-term investment. Investment of EF in real estate was either made in the form of private equity funds or by purchase of real estate property directly by HKMA. As regards risk assessment, CE/HKMA said that no investment was free from risks. HKMA had put in place internal guidelines for investment risk management and control, and would exercise prudence in real estate investment by giving due regard to the quality and potential investment return of the real estate in question.

25. DCE(M)/HKMA supplemented that the inclusion of new asset classes such as real estate was meant to diversify EF's investment, taking into account the low correlation in returns between the new asset classes and the traditional ones (mainly bonds and equities). In making investment in real estate, HKMA would identify prime-quality properties in major overseas cities and international financial centres, which had growth potentials, and would bring about a stable rental income. The rental income of similar real estate projects stood at about 4% to 6% on average. As of now, HKMA had not invested in real estate projects in Hong Kong.

26. Mr Christopher CHEUNG enquired whether HKMA invested in real estate overseas because the investment return from Hong Kong properties was relatively less favourable. He also asked if HKMA would consider making EF investment in the local real estate market. CE/HKMA explained that, as HKMA was a regulator of the banking sector which implemented prudential supervisory measures that would impact on, amongst others, the mortgage underwriting standards of banks, investment in the Hong Kong real estate by HKMA might give rise to conflict of roles and interests.

II Any other business

27. There being no other business, the meeting ended at 10:34 am.

Council Business Division 1
Legislative Council Secretariat
4 February 2014