

*The Governance of the  
Hong Kong Monetary Authority  
and Comparable Authorities  
in Hong Kong and Overseas Jurisdictions*

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# Executive Summary

1. This research studies the governance of the Hong Kong Monetary Authority (HKMA). It also discusses the governance of local government departments and statutory bodies, and overseas financial regulatory authorities. The impact of the accountability system for Principal Officials on the governance of local authorities is studied as well.
2. The local government departments and statutory bodies studied comprise the Office of the Telecommunications Authority (OFTA), the Trade and Industry Department (TID), the former Housing Department (HD), the Securities and Futures Commission (SFC), and the Mandatory Provident Fund Schemes Authority (MPFA).
3. The overseas financial regulatory authorities studied comprise the Bank of England (the Bank) and the Financial Services Authority (FSA) in the United Kingdom (UK); the Federal Reserve System (Fed), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC) in the United States of America (US); the Monetary Authority of Singapore (MAS); and the Government of Singapore Investment Corporation (GIC).
4. The comparison between HKMA and other authorities is made in terms of the powers and functions, organizational structure, funding arrangements, mechanism for approving and controlling expenditure, staff remuneration arrangements and accountability arrangements of these authorities.

## Powers and functions

5. HKMA is headed by the Monetary Authority (MA) who is a person appointed by the Financial Secretary (FS) pursuant to the Exchange Fund Ordinance (EFO). OFTA, TID and HD are government departments, whereas SFC, MPFA and all overseas authorities studied are established by law as statutory bodies.
6. The powers and functions of MA are set out in two pieces of legislation, namely the Banking Ordinance (BO) and EFO. BO details the powers and functions of MA relating to the regulation of the banking sector, whereas EFO stipulates MA to (a) assist FS in the performance of his functions under EFO, (b) perform such functions as FS may direct, and (c) perform functions imposed on or assigned to MA by any other Ordinance. Most of the other authorities studied have their operations governed by legislation which sets out their exact powers and functions.
7. MA is responsible for assisting FS in controlling EF and regulating the banking industry, and these two functions are performed through HKMA. The management of foreign exchange reserves and the regulation of the banking sector are performed by separate authorities in the overseas jurisdictions studied.

8. In Hong Kong, the supervision of a financial institution by HKMA covers both prudential supervision and conduct regulation regarding the institution's various business operations. The US adopts a multiple-regulator regime under which the Securities and Exchange Commission regulates securities activities and the financial regulatory authorities supervise banking activities. Meanwhile, the UK has resorted to a single-regulator regime under which FSA is the single regulator of all financial services. Nonetheless, FSA is of the view that prudential supervision and conduct regulation are two different areas of specialization that should be conducted by separate bodies.

#### Organizational structure

9. Under EFO, FS is advised on the control of EF by the Exchange Fund Advisory Committee (EFAC), of which he is the ex-officio chairman. In practice, EFAC also serves as the de facto management board of HKMA. While EFAC is not involved in the direct regulation or supervision of banks, banking policy issues with implications on EF or its objectives are referred to EFAC for advice. For the local and overseas statutory bodies, their management boards are responsible solely for policy formulation and oversight of day-to-day operations.
10. There are neither statutory requirements prescribing the membership of EFAC, nor rules governing the removal of EFAC members. SFC, MPFA and the overseas authorities studied have put in place rules governing their board membership and/or removal of a board member from office.

#### Funding arrangements

11. The expenditure of HKMA is charged to EF. Major sources of income for EF are interests and dividends from listed equity securities. Section 6(a) of EFO provides that the emoluments payable to, and other staff costs relating to, the persons employed in connection with the purposes of EF are charged to EF. Furthermore, section 6(b) of EFO stipulates that any incidental expenditure which the Chief Executive of the Hong Kong Special Administrative Region (CE of HKSAR) may approve as necessary for the due performance of the duties laid upon FS and EFAC in connection with the operation of EF is charged to EF. The Government's intention of making this funding arrangement for HKMA was to take the Authority outside the resource allocation constraints applicable to other parts of government, which are funded by the general revenue.
12. Most of the other authorities studied in this research are operating on a self-financing basis, with some having revenues derived from investment returns generated from the government's capital grant and revenues from services provided. Others derive revenues from fees and charges levied on services provided, or earnings from the holdings of government securities.

### Mechanism for approving and controlling expenditure

13. All authorities studied, including HKMA, take into consideration the determined policy objectives/tasks for the upcoming financial year when preparing their budgets. In addition, they follow similar financial control procedures, with their financial statements being audited by internal and/or external auditors. Some authorities have also established an internal audit committee as an additional financial control.

### Staff remuneration arrangements

14. Section 5A(1) of EFO provides for FS to appoint a person to be MA on such terms and conditions as he thinks fit. In practice, FS acts on the advice of EFAC to determine the terms and conditions of the staff of HKMA, including MA. In the UK, the remuneration package for the chief executive of a regulatory body is determined by the management board. In the US, Congress approves the remuneration packages for the chief executives of the regulatory bodies.
15. There is no publicly available information on HKMA's remuneration policy. The same applies to both SFC and MPFA. The regulatory authorities in the UK and the US have made their remuneration policies publicly available.

### Accountability arrangements

16. While MA is appointed by FS, the other EFAC members are appointed by CE of HKSAR. In the UK, the US and Singapore, the appointments of heads of the authorities and/or board members are made by the government.
17. MA must prepare and furnish to FS a report on the working of BO and on the activities of his office during the preceding year. In addition, MA is required to report to FS on improvements that he considers to be desirable in the operation and management of his office. OFTA, SFC, MPFA are also required to submit to the Administration annual reports, financial statements and reports on their operations/internal management controls. Similar requirements apply to the overseas authorities studied as well.
18. The budgets of HKMA, OFTA, SFC and MPFA are subject to the approval of the Administration. The same holds for the budgets of MAS and GIC in Singapore. The financial regulatory authorities in the UK and the US adopt different arrangements, with their budgets being approved by the board and the head of the authority respectively.

19. Among the overseas jurisdictions studied, the UK and the US have both established a system for the appointment of the chief executives and board members of financial authorities. In the UK, the appointments are subject to open recruitment as required by the Nolan Principles. In the US, the appointments are made by the US President and confirmed by the Senate. However, in Hong Kong, the local authorities have not published the criteria of appointing the board members.
20. All of the authorities studied are subject to scrutiny by the legislature. In the US, federal statute further empowers Congress to confirm the appointments of board members and/or heads of the financial regulatory authorities. The salaries payable to the heads of these authorities are also subject to the approval of Congress.
21. All of the authorities studied keep the public informed of their policies and operations through posting relevant papers and documents on their respective websites. They also conduct various public education and community programmes.

Impact of the accountability system for Principal Officials on the governance of the local authorities

22. The accountability system for Principal Officials was introduced in July 2002. Both HKMA and MPFA do not expect that the accountability system would affect their operations. OFTA, TID and SFC have not made any assessment on the system so far. According to HKMA, the powers and functions of MA have been set out clearly in EFO and BO, and MA will continue to discharge his duties in accordance with these two pieces of legislation.

# **The Governance of the Hong Kong Monetary Authority and Comparable Authorities in Hong Kong and Overseas Jurisdictions**

## **Part 1 - Introduction**

### **1. Background**

1.1 The Panel on Financial Affairs (the Panel) requested the Research and Library Services Division (RLSD) to conduct a research on "the Governance of the Hong Kong Monetary Authority" at its meeting on 9 April 2002. The study was intended to cover the governance of the Hong Kong Monetary Authority (HKMA) and that of the government departments and statutory bodies of Hong Kong.

1.2 On 6 May 2002, the Panel further requested RLSD to include a comparison between the governance of HKMA and that of other comparable regulatory authorities of overseas jurisdictions, and an assessment of the impact of the accountability system of Principal Officials on the governance of HKMA in the study.

1.3 HKMA is part of the Government and is responsible for the management of the Exchange Fund (EF). It is also responsible for the stability and effective working of the banking system. MA, the Chief Executive of HKMA, reports to the Financial Secretary (FS). FS is advised by the Exchange Fund Advisory Committee (EFAC), of which he is the ex-officio chairman. EFAC also comprises non-government members appointed by the Chief Executive of the Hong Kong Special Administrative Region (CE of HKSAR).

1.4 The Panel has found it necessary to study HKMA which, unlike other government bureaux/departments, does not require approval by the Legislative Council (LegCo) of its annual budget.

1.5 Notwithstanding the fact that the Chief Executive of HKMA reports to the Panel three times a year on the work of HKMA, Members of the Panel find that the governance of HKMA ought to be reviewed, especially when HKMA is assuming greater responsibilities with the rapid development of the financial sector in Hong Kong. In addition, the recent purchase of office premises by HKMA, without going through the financial procedures applicable to government bureaux/departments, has also raised much concern.

## **2. Selection of government departments and statutory bodies of Hong Kong**

2.1 For the purpose of providing comparison on the governance of HKMA, RLSD selected the following local government departments and statutory bodies:

- (a) Office of the Telecommunications Authority (OFTA);
- (b) Trade and Industry Department (TID);
- (c) former Housing Department<sup>1</sup> (HD);
- (d) Securities and Futures Commission (SFC); and
- (e) Mandatory Provident Fund Schemes Authority (MPFA).

2.2 OFTA is a government department which has been operating as a trading fund since June 1995. Its funding is supported by income derived mainly from licence fees. OFTA is the executive arm of the Telecommunications Authority, which is responsible for regulating the telecommunications industry in Hong Kong.

2.3 TID is a typical government department which levies charges on its services. The incomes of TID are credited to the General Revenue Account. The expenditure of TID requires the approval from LegCo.

2.4 The former HD was a government department which was financially independent from the Administration and served as the executive arm of the Hong Kong Housing Authority.

2.5 SFC and MPFA are statutory bodies which function as industry regulators in the financial sector. SFC is responsible for regulating the securities and futures industry of Hong Kong, while MPFA is entrusted with the regulation and supervision of the Mandatory Provident Fund schemes.

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<sup>1</sup> On 1 July 2002, a new housing organization was formed with the former HD merged with its policy bureau, the Housing Bureau. This new organization, which comes under the new Housing, Planning and Lands Bureau, retains the name of "Housing Department".

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### **3. Selection of regulatory authorities of overseas jurisdictions**

3.1 RLSD selected the following overseas jurisdictions and their respective regulatory authorities for the study:

- (a) The United Kingdom (UK)
  - (i) The Bank of England, the central bank of the UK; and
  - (ii) Financial Services Authority (FSA), the authority responsible for regulating the financial services industry.
- (b) The United States of America (US)
  - (i) The Federal Reserve System, the central bank of the US;
  - (ii) Office of the Comptroller of the Currency (OCC), a bureau of the Department of the Treasury which regulates the national banking industry and agencies of foreign banks;
  - (iii) Office of Thrift Supervision (OTS), a bureau of the Department of the Treasury which regulates federally chartered and state chartered thrifts; and
  - (iv) Federal Deposit Insurance Corporation (FDIC), a federal government agency which provides insurance protection for depositors at most commercial banks and saving associations.
- (c) Singapore
  - (i) Monetary Authority of Singapore (MAS), the authority responsible for setting monetary policies, supervising the financial industry and issuing government securities; and
  - (ii) Government of Singapore Investment Corporation (GIC), the authority responsible for managing Singapore's foreign exchange reserves.

3.2 The UK, the US and Singapore are all characterized by the presence of an international financial centre within their respective territory. Hence, the study of regulatory authorities providing similar functions to those of HKMA in these jurisdictions may provide useful reference for Members when discussing the governance of HKMA.

#### **4. Scope of the research**

4.1 The scope of the research, as agreed by the Panel, covers:

- (a) a comparison between the governance of HKMA and that of the local government departments/statutory bodies;
- (b) a comparison between the governance of HKMA and that of comparable regulatory authorities of overseas jurisdictions; and
- (c) the impact of the accountability system of Principal Officials on the governance of HKMA.

#### **5. Terms and definitions**

##### Monetary Authority and Hong Kong Monetary Authority

5.1 Legally speaking, the Monetary Authority (MA) is a person vested with the powers and functions set out in the Exchange Fund Ordinance (EFO) and the Banking Ordinance (BO).

5.2 In practice, the term "MA" has been regarded as an organization known as HKMA, which is an integral part of the Government. In effect, HKMA is headed by MA. The institutional identity of the term "MA" was identified in the LegCo Brief submitted by the then Secretary for Monetary Affairs on 22 October 1992. Paragraph 22 of the Brief states that *"legally, the Monetary Authority would be a person rather than an institution. But in practice the term "Monetary Authority" would be regarded by the outside world as an organization. Administrative arrangements would ensure that its institutional identity would be prominent."*

5.3 For the purpose of this study, while recognizing MA as a person, this research will focus on the institutional identity of MA, i.e. HKMA, although it is not established by either EFO or BO.



### Exchange Fund Advisory Committee

5.4 The powers and functions of EFAC, of which FS is the ex-officio chairman, are set out in EFO. Section 3(1) of EFO requires FS to exercise his control of EF in consultation with EFAC. As such, the statutory role of EFAC is to advise FS on general policies relating to the deployment of EF. Section 3(2) stipulates that FS is required to consult EFAC to enter into any financial arrangement that he considers appropriate for the prudent management of EF. In addition, section 8 provides that FS should consult EFAC and obtain the prior approval of the Chief Executive in Council when he transfers EF surplus to the General Revenue Account. Section 6(b) empowers CE of HKSAR to pay out of EF incidental expenditure necessary for the due performance of duties laid upon EFAC in connection with the operation of EF. In practice, EFAC also serves as the de facto management board of HKMA. For the purpose of this study, this research will focus on two major functions of EFAC, namely advising FS on general policies relating to the deployment of EF and serving as the de facto management board of HKMA.

### Governance

5.5 In this study, "governance" denotes how a governmental or regulatory authority derives its powers and the way it seeks and makes use of its funding to perform its functions. "Governance" also denotes how the authority is monitored and held accountable for the functions it performs, particularly the accountability arrangements with respect to the public and other relevant parties.

5.6 Many international organizations, such as the Organization for Economic Cooperation and Development, have identified the following three common elements which an authority should incorporate into its governance:

- (a) accountability — the authority being answerable for its decisions and responsive to entities from which they derive its powers;
- (b) predictability — existence of clear, transparent laws and regulations, as well as consistence and coherence in policy formulation; and
- (c) transparency — availability of information to the general public and clarity about rules, regulations and decisions of the authority concerned. Transparency also means that decisions taken and their enforcement are done in a manner that follows rules and regulations.

### Operational independence

5.7 Operational independence refers to the autonomy enjoyed by an authority in conducting its day-to-day operations within its policy and legal frameworks. An authority, working with operational independence, should be safeguarded against the influence of political considerations and interference from other authorities.

## **6. Methodology**

6.1 The research involves a combination of information collection and analysis. In addition to making reference to materials available in the LegCo Library, RLSD also uses reference materials acquired through the Internet and other outside sources.

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## Part 2 - Hong Kong Monetary Authority, Hong Kong

### 7. Background to the appointment of the Monetary Authority

7.1 The Exchange Fund Ordinance<sup>2</sup> (EFO) (Cap. 66) was amended in December 1992<sup>3</sup> to provide for the appointment of the Monetary Authority (MA)<sup>4</sup> on 1 April 1993, by merging the Office of the Exchange Fund (OEF) with the Office of the Commissioner of Banking (OCB). This arrangement was made to ensure that *"the official duties in the monetary and banking fields could be performed with a high degree of professionalism and continuity, in a manner that commanded the confidence of the people of Hong Kong and the international financial community."*<sup>5</sup>

7.2 Prior to the appointment of MA, the former Monetary Affairs Branch (MAB) was responsible for setting policies in respect of monetary affairs and financial services, as well as controlling and managing the assets and liabilities of the Exchange Fund (EF). MAB comprised a Financial Services Division which dealt with policies on banking supervision, insurance and company laws; a Special Unit which was tasked with policy responsibility in respect of the securities, commodities and futures markets; and a Legal Unit which provided legal advice and support. Under MAB, there were three separate offices with executive functions -- OEF, OCB and the Office of the Commissioner of Insurance (OCI).

7.3 At that time, the Government had several monetary policy objectives:

- (a) to maintain exchange rate stability and public confidence in the currency;
- (b) to maintain general stability and a high level of integrity in the monetary and financial systems of Hong Kong; and
- (c) to facilitate the maintenance and development of Hong Kong as an international financial centre.

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<sup>2</sup> The Exchange Fund of Hong Kong was established by the Currency Ordinance of 1935 (later renamed the Exchange Fund Ordinance).

<sup>3</sup> The Administration briefed the Panel on Finance, Taxation and Monetary Affairs about the Exchange Fund (Amendment) Bill 1992 (the Bill) on 31 October 1992. The Bill was introduced into the Legislative Council at the sitting on 4 November 1992. The Administration had conferred with some Members and agreed with them to move a Committee Stage Amendment (CSA). The House Committee was made aware of that all along. The Legislative Council passed the Bill on 9 December 1992.

<sup>4</sup> As mentioned in paragraph 5.2 above, legally, MA is a person rather than an institution. However, in practice, the term "MA" has been regarded as an organization so that an institutional identity is prominent.

<sup>5</sup> The speech delivered by the then Secretary for Monetary Affairs in the Legislative Council on 4 November 1992 when he moved the Exchange Fund (Amendment) Bill 1992 to be read a second time, paragraph 3.

7.4 These objectives were consistent with the provisions both in the Sino-British Joint Declaration<sup>6</sup> and the Basic Law (Articles 109 to 113). The extent to which these objectives were achieved successfully had a direct bearing on the stability and prosperity of Hong Kong. Aiming at the achievement of these objectives, the Government engaged in the following tasks:

- (a) macro-monetary management (e.g. management of exchange rates and interest rates);
- (b) prudential supervision of banks and other authorized institutions<sup>7</sup>;
- (c) regulation of securities markets;
- (d) development of bond and short-term financial markets; and
- (e) management of the assets of EF.

7.5 A series of monetary reform measures, designed to suit Hong Kong's particular circumstances, were implemented to strengthen Hong Kong's monetary and financial systems. In respect of monetary policy and reserves management, the Government reviewed the situation and proposed to implement the recommendations of the review to strengthen Hong Kong's capacity in monetary and reserves management and in banking supervision.

#### Statutory recognition of Hong Kong's monetary policy objectives

7.6 The Government considered that the monetary policy objectives mentioned in paragraph 7.3 above should be given statutory recognition. This could be achieved by suitably amending EFO to authorize the Financial Secretary (FS), in addition to the then primary use of EF to affect directly or indirectly the exchange value of the currency of Hong Kong, to use EF as he thought fit to provide a measure of protection against risk to the stability and the integrity of the monetary and financial systems of Hong Kong, with a view to maintaining Hong Kong as an international financial centre.

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<sup>6</sup> There is a requirement in the Sino-British Joint Declaration that the Hong Kong Special Administrative Region will retain the status of an international financial centre.

<sup>7</sup> Hong Kong maintains a three-tier system of deposit-taking institutions — licensed banks, restricted license banks and deposit-taking companies — which are collectively called authorized institutions under the Banking Ordinance. Presently, HKMA is the licensing authority for all three types of authorized institutions.

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7.7 The secondary use of EF would enable FS to assume responsibility for banking supervision and address problems with systemic implications. EF would not be used for bailing out individual banks per se although there might be occasions where the rescue of an individual bank was necessary to prevent a domino effect across the whole banking system. Furthermore, in exercising these secondary powers under EFO, FS had to account for the primary purpose of EF. Should there be any conflict, the primary purpose would prevail.

## **8. Establishment of the Hong Kong Monetary Authority**

8.1 To assist FS to perform the extended duties laid upon him in EFO, it was proposed that OEF should be reconstituted by merging with OCB, and be renamed the Hong Kong Monetary Authority (HKMA). For HKMA to perform its duties effectively, the Government considered that HKMA should have:

- (a) a high degree of flexibility in acquiring and deploying adequate manpower and other resources in response to priorities, without being subject to the constraints of resource allocation and personnel procedures applicable to other government departments;
- (b) a proper and more flexible career structure for its staff in order to provide for the much needed continuity and professionalism in monetary management, reserves management and other related fields; and
- (c) a clear institutional identity to facilitate co-operation with central banks and monetary authorities in other financial centres and with international organizations such as the International Monetary Fund and the World Bank.<sup>8</sup>

8.2 The Government envisaged that MA would be organized in the following way:

- (a) the use and management of EF would remain the statutory responsibility of FS although he would delegate his authority to the senior staff of HKMA as appropriate; and

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<sup>8</sup> Legislative Council, *Minutes of the Establishment Sub-Committee of the Finance Committee*, 22 February 1993.

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- (b) MA would remain an integral part of the Government<sup>9</sup>, but FS could employ staff on terms and conditions different from those of the civil service. Provisions would be made for those who wish to remain as civil servants. The staff and operating costs of the new body would be charged directly to EF instead of the General Revenue Account, resulting in it not being subject to the resource allocation constraints applicable to other Government departments. MA would be responsible to FS, who was advised by the Exchange Fund Advisory Committee (EFAC), of which FS was the ex-officio Chairman.

8.3 Apart from the creation of a Chief Executive post in the new body, OEF and OCB would be merged without any significant changes initially in their existing organizational structures and staffing levels. All the serving officers in both OEF and OCB would be transferred to HKMA on secondment terms with no change to their pay and conditions of service.

#### Proposed structure of the Hong Kong Monetary Authority

8.4 HKMA would be headed by a Chief Executive, at the rank of Secretary, Government Secretariat (D8). The Chief Executive would report directly to FS and assist him in achieving the monetary policy objectives laid down in EFO as amended. He would have overall charge of monitoring the monetary system and initiation of related policies; management of the assets of EF; banking supervision; and the exercise of other powers under EFO as delegated by FS.

8.5 The Chief Executive would be underpinned by two Deputy Chief Executives (D6). One of the deputy posts corresponded to the post of the Commissioner of Banking (D6) in charge of banking supervision and related matters. The other deputy post corresponded to the post of the Director of OEF (D6) in charge of monetary management and investment of EF assets. Consequently, all existing posts and staff in OCB and OEF, comprising 14 directorate and 252 non-directorate posts, would be transferred to HKMA. Some retitling of posts would take place but the responsibilities of these posts would remain basically the same. The Legal Adviser (DL2) and four non-directorate posts of the Legal Unit of MAB would also be transferred to HKMA to provide legal support to HKMA. There would be no significant change to the staffing level on the establishment of HKMA other than the creation of an additional post of Secretary, Government Secretariat as the Chief Executive.

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<sup>9</sup> Article 113 of the Basic Law provides that the Exchange Fund of the Hong Kong Special Administrative Region shall be managed and controlled by the government of the Region, primarily for regulating the exchange value of the Hong Kong dollar. To comply with the Article 113 of the Basic Law, it was considered important that MA should not be separated from the Government.

### Proposed financial arrangements for the Hong Kong Monetary Authority

8.6 The staff and operating costs of HKMA would be charged to EF instead of the General Revenue Account. The part of the costs incurred by MA in respect of banking supervision functions, which were covered by banking and related licence fees collected from authorized institutions, would be reimbursed by the General Revenue Account to EF.

8.7 In line with EFO as amended, HKMA would have the necessary flexibility to acquire and deploy staff and other resources. Under the direction of FS and on the advice of EFAC, MA would be able to employ staff to fill HKMA posts on terms different from those of the civil service, so as to attract and retain staff of high calibre and with the right experience. Under section 5A of the amended EFO, FS has the authority to employ people in connection with the purposes of EF on such terms as he thinks fit.

8.8 It was intended that, initially, HKMA would create non-civil service posts (HKMA posts) primarily for specialist jobs for which the necessary experience and expertise were not readily available within the civil service. The creation of HKMA posts would be in accordance with the staffing proposal in the HKMA budget approved by FS on the advice of EFAC. As these were non-civil service posts, their creation would be authorized by FS under the provisions of EFO.

8.9 The above proposed structure and financial arrangements served as the blueprint for HKMA upon its inception in April 1993. As at 31 December 1993, the number of HKMA staff was 289.

## **9. Powers and functions of the Monetary Authority**

9.1 The powers and functions of MA are set out in two pieces of legislation, namely EFO and the Banking Ordinance (Cap. 155) (BO). The details are discussed below:

### Power and functions of the Monetary Authority under the Exchange Fund Ordinance

9.2 Section 3 of EFO provides that EF has two purposes:

- (a) affecting the exchange value of the currency of Hong Kong; and
- (b) maintaining the stability and integrity of the monetary and financial systems of Hong Kong, with a view to maintaining Hong Kong as an international financial centre.

9.3 EFO stipulates that FS is responsible for controlling EF and should use EF for the purposes specified in paragraph 9.2 above. EFO also requires that FS should consult with EFAC for the control of EF. (See paragraphs 10.1 - 10.9 below for details of EFAC.)

9.4 As the controller of EF, FS is empowered to:

- (a) control and manage EF which should be used to affect either directly or indirectly the exchange value of the currency of Hong Kong and for other purposes incidental thereto;
- (b) buy or sell currency, foreign exchange, gold, silver, securities or assets accordingly; and after having consulted EFAC, enter into any financial arrangement that he considers appropriate for the prudent management of EF;
- (c) appoint a person to be MA on such terms and conditions as he thinks fit;
- (d) require an authorized institution to open an EF account with MA and to maintain and operate such account on such terms and conditions as FS considers appropriate having regard to the purposes of EF;
- (e) issue a certificate of indebtedness to any note-issuing bank to be held as cover for legal tender notes;
- (f) borrow for the account of EF, either in Hong Kong or elsewhere, on the security of the General Revenue Account; and
- (g) transfer EF surplus to the General Revenue Account, after consulting EFAC, and with the prior approval of the Chief Executive in Council.<sup>10</sup>

9.5 Under section 5A(2), MA is required to carry out the following functions:

- (a) assist FS in the performance of his functions under EFO;
- (b) perform such functions as FS may direct; and
- (c) perform functions imposed on or assigned to MA by any other Ordinance.

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<sup>10</sup> Legally, it is required to maintain the assets of the Fund at 105% of the total obligations of EF.

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9.6 Section 5B of EFO further provides that FS may delegate to MA the powers and duties conferred or imposed on FS under EFO, but such a delegation should not preclude FS from exercising the powers and duties delegated.

9.7 Under EFO, MA is responsible to FS. The relationship between FS and MA is that of an appointor who determines terms and conditions of appointment and an appointee. However, EFO does not specify the exact scope of the powers and functions of MA, which should primarily be determined by FS.

#### Powers and functions of the Monetary Authority under the Banking Ordinance

9.8 As a result of amendments made to BO by the Exchange Fund (Amendment) Ordinance 1992 in December 1992, powers and functions of the former Commissioner of Banking was vested in MA with effect from 1 April 1993.

9.9 Under section 7 of BO, the principal function of MA is to promote the general stability and effective working of the banking system. In particular, MA is required to carry out the following functions:

- (a) supervise the compliance with the provisions of BO;
- (b) ensure that the principal places of business, local branches, overseas branches and overseas representative offices of all authorized institutions and local representative offices are operated in a responsible, honest and business-like manner;
- (c) promote and encourage proper standards of conduct and sound and prudent business practices amongst authorized institutions and money brokers;
- (d) suppress illegal, dishonourable or improper business practices of authorized institutions;
- (e) co-operate with and assist recognized financial services supervisory authorities of Hong Kong or of any place outside Hong Kong, whenever appropriate, to the extent permitted by BO or any other Ordinance; and
- (f) consider and propose reforms of the legislation relating to banking and deposit taking businesses.

9.10 Under BO, MA is responsible to FS. Section 9 of BO provides that MA is required to, as soon as practicable after 31 December of each year, prepare and furnish to FS a report on the working of BO and on the activities of his office<sup>11</sup> during the preceding year. In the report, MA may set out any measures for improving the working of BO and the activities of his office. In addition, MA is required to report to FS on improvements that he considers to be desirable in the operation and management of his office.

9.11 MA may also be requested to submit reports to the Chief Executive of the Hong Kong Special Administration Region (CE of HKSAR) on matters relating to the working of BO or activities of his office.

#### Policy objectives and main functions stated by the Hong Kong Monetary Authority

9.12 To keep the public informed of its roles, HKMA sets out the policy objectives and main functions in its publications and website. HKMA's policy objectives are:

- (a) to maintain currency stability within the framework of the linked exchange rate system, through sound management of EF, monetary policy operations and other means deemed necessary;
- (b) to promote the safety and stability of the banking system through regulation of banking and deposit taking businesses, and supervision of authorized institutions; and
- (c) to enhance the efficiency, integrity and development of the financial system, particularly payment and settlement arrangements.

9.13 HKMA's main functions are to keep the Hong Kong dollar stable and manage EF in a sound and effective way.

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<sup>11</sup> The office of MA is known as HKMA.

9.14 In addition, to maintain the stability and integrity of the financial system of Hong Kong, HKMA is responsible for<sup>12</sup>:

- (a) providing a measure of protection to depositors and promoting the general stability and effective working of the banking system through the regulation of banking business and the business of taking deposits, and the supervision of authorized institutions as provided for in BO;
- (b) determining on his own prudential policies, and standards and guidelines relating to the regulation of banking business and the business of taking deposits;
- (c) considering and proposing reforms of the law relating to the regulation of banking business and the business of taking deposits;
- (d) co-operating with other relevant authorities in the supervision of business conducted by authorized institutions (other than banking business or the business of taking deposits);
- (e) developing the debt market in co-operation with other relevant authorities and organizations;
- (f) matters relating to the issuance and circulation of legal tender notes and coins;
- (g) promoting the safety and efficiency of the financial infrastructure through the development of domestic wholesale and retail payment, clearing and settlement systems involving authorized institutions and, where appropriate, the operation of these systems; and
- (h) other operations and schemes as appropriate.

9.15 According to MA, he may in the long term take on new duties relating to consumer protection for banking customers, supervision of the deposit insurance system, the Credit Reference Agency, etc.<sup>13</sup>

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<sup>12</sup> Hong Kong Monetary Authority, Information Note for Legislative Council Panel on Financial Affairs, *Governance of the Hong Kong Monetary Authority*, 27 September 2002, LC Paper No. CB(1)2606/01-02.

<sup>13</sup> Legislative Council Panel on Financial Affairs, *Background Brief on Permanent Accommodation for the Hong Kong Monetary Authority*, Meeting on 5 November 2001, LC Paper No. CB(1)169/01-02 (05), paragraph 5.

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9.16 To maintain the status of Hong Kong as an international financial centre, HKMA seeks to promote:

- (a) the development of payment, clearing and settlement systems to facilitate the safe and efficient conduct of international and cross-border financial activities in Hong Kong;
- (b) confidence in Hong Kong's monetary and financial systems through active participation in international financial and central banking forums; and
- (c) appropriate market development initiatives that help strengthen the international competitiveness of Hong Kong's financial services.

## **10. Organizational structure**

### The Exchange Fund Advisory Committee: the de facto management board

#### *Functions*

10.1 Pursuant to section 3(1) of EFO, the role of EFAC is to advise FS, who is the controller of EF, on general policy relating to the deployment of EF. In fact, FS is the ex-officio chairman of EFAC. In the reply to our enquiry regarding the practical roles and functions of EFAC, HKMA states that EFAC serves as the de facto management board of HKMA which derives from its advisory functions in respect of FS's control of EF. (See paragraph 9.3 for the statutory role of EFAC.)

10.2 EFAC also advises FS on the following aspects:

- (a) operations of the currency board arrangements;
- (b) operations of HKMA;
- (c) approval of annual HKMA's budget; and
- (d) the terms and conditions of service of the staff of HKMA.

10.3 EFAC is not involved in the direct regulation or supervision of banks. However, banking policy issues with implications on EF or EF's objectives are referred to EFAC for advice. An example is the Lender of Last Resort Policy. Since it might involve the use of EF, matters relating to this Policy are referred to EFAC for advice. Such involvement of EFAC relating to the regulation of the banking sector is not prescribed in both EFO and BO.

### *Membership of the Exchange Fund Advisory Committee*

10.4 According to HKMA, members of EFAC are appointed in a personal capacity and not as representatives of any particular sector or profession. They are appointed because of their expertise and experience in the respective fields.

10.5 In the past, EFAC members were mainly from the banking sector. For example, in 2000, out of the nine EFAC members, six were from the banking sector, two were from non-banking sectors and one was the ex officio member (i.e. MA). Consequently, some legislators were concerned that EFAC might be ineffective in monitoring the operations of HKMA, as the majority of members were from the banking sector which was in turn regulated by HKMA.

10.6 The membership of EFAC was expanded in December 2001, adding four members from the fields of trade, industry and legal services. Currently, there are 13 EFAC members, consisting of the Chairman (i.e. FS), MA, five members from the banking sector, and six members from non-banking sectors. According to HKMA, the EFAC membership will not be expanded in the near future.

### *Appointment*

10.7 Members of EFAC are appointed by CE of HKSAR, who has delegated this authority to FS to make such appointments.

10.8 There is no statutory provision for the term of office of EFAC members. In practice, members are normally appointed for a term of two years. The exception is MA, whose appointment to EFAC has no fixed term. There are also no statutory rules for removing EFAC members.

### *Meetings*

10.9 EFAC meets regularly and on other occasions when particular advice is being sought. 33 EFAC meetings were held from January 1999 to December 2001. According to HKMA, much of the business dealt with at EFAC meetings is market-sensitive. Release of records of EFAC meetings might have an impact on the market, and such records are therefore not published.

### The Exchange Fund Advisory Committee Sub-committee on Currency Board Operations

10.10 The EFAC Sub-Committee on Currency Board Operations (the Sub-Committee) was established in August 1998 for advising FS through EFAC on the operation of the currency board arrangements in Hong Kong. It is responsible for, among other things, ensuring that currency board operations are conducted in accordance with established policies, recommending improvements to the currency board system, and ensuring a high degree of transparency in the operation of the currency board system. MA is the Chairman of the Sub-committee. The records of the Sub-Committee's deliberations are published within a few weeks after the meeting.

### The Banking Advisory Committee and the Deposit-taking Companies Advisory Committee

10.11 The Banking Advisory Committee (BAC) and the Deposit-taking Companies Advisory Committee (DCAC) are established under the provisions of BO for the purpose of advising CE of HKSAR on matters relating to BO, in particular, those relating to business activities of banks, restricted licence banks and deposit-taking companies. Both Committees are chaired by FS, with other members being appointed by FS under the delegated authority conferred by CE of HKSAR. MA is an ex officio member of both Committees. Both BAC and DCAC hold meetings once every three months.

### Chief Executive's Committee

10.12 The day-to-day operations of HKMA are managed by the Chief Executive's Committee (CEC), with the Chief Executive of HKMA being the Chairman. The role of CEC, which meets once a week, is to report to the Chief Executive of HKMA on the progress of major tasks being undertaken by the various departments of HKMA and to advise him on policy matters relating to the operations of HKMA. HKMA comprises eight departments and the office of the General Counsel. (See Appendix I for the organizational structure of HKMA.)

## 11. Funding of the Hong Kong Monetary Authority

11.1 The activities of HKMA are directly financed by EF. Major sources of income for EF are interests and dividends from listed equity securities. Section 6(a) of EFO provides that the emoluments payable to, and other staff costs relating to, the persons employed in connection with the purposes of EF are charged to EF. Furthermore, section 6(b) of EFO stipulates that any incidental expenditure which CE of HKSAR may approve as necessary for the due performance of the duties laid upon FS and EFAC in connection with the operation of EF is charged to EF.

11.2 According to the then Secretary for Monetary Affairs, the intention of making this funding arrangement for HKMA was "*to take the Authority outside the resource allocation constraints applicable to other parts of government, which are funded by the general revenue.*"<sup>14</sup> This was a continuation of the practice before the establishment of HKMA in April 1993, when the administrative expenditure of managing EF had been charged to EF.<sup>15</sup>

### Bank licence fees

11.3 Another source of income for EF is bank licence fees receivable from authorized institutions at a rate approved by LegCo and credited to the Exchange Fund Account. Bank licence fees amounted to HK\$154 million in 2001<sup>16</sup>.

## 12. Mechanism for approving and controlling expenditure

### Budgetary process

12.1 The administrative budget is prepared annually by HKMA for approval by FS on the advice of EFAC. The budget applies to the calendar year and is normally approved in November of the preceding year.

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<sup>14</sup> See paragraph 5 of the speech delivered by the then Secretary for Monetary Affairs in the Legislative Council on 4 November 1992.

<sup>15</sup> This contrasted with the expenditure of the ex-Office of the Commissioner of Banking which was charged to the General Revenue Account.

<sup>16</sup> HKMA is unable to provide the figures or even a rough estimate for the cost incurred on regulating authorized institutions. According to HKMA, the responsibilities of its banking departments are not solely on regulating function but also on policy making and development of the banking sector. Further, other departments of HKMA also provide assistance or support to the banking departments when needed.

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### Total expenditure

12.2 The total expenditure of HKMA amounted to HK\$1.07 billion in 2001. Staff costs totalled HK\$0.48 billion, which accounted for 44.9% of the total expenditure. In the expenditure account, other operating expenses, amounting to HK\$0.398 billion in 2001, comprised mainly management fees for external managers and custodian fees, and partly the administrative expenses of HKMA.

### *Capital expenditure*

12.3 According to HKMA, capital expenditure is covered in its annual administrative budget. Hence, there is no difference between the approval mechanism for capital expenditure and that for operating expenditure. In 2001, the total capital expenditure of HKMA was HK\$597 million. It comprised HK\$558 million for the partial payment of the purchase of the new office accommodation for HKMA and HK\$39 million for other fixed assets.

12.4 In regard to capital expenditure, some LegCo Members expressed serious concern over the purchase of the permanent accommodation for HKMA.<sup>17</sup> At the meeting of the Panel on Financial Affairs (the Panel) on 11 January 2001, the Chief Executive of HKMA informed Members that with the approval of FS, HKMA was negotiating with the developer of Two International Finance Centre on the acquisition of office premises.

12.5 The subject was discussed at the Panel meeting on 20 April 2001 with the knowledge that the acquisition of the office premises would be charged to EF, hence would not require the approval of the Finance Committee. A follow-up discussion was held at the Panel meeting on 3 May 2001. At that meeting, the Panel noted that FS had signed a Memorandum of Understanding (MOU) on 28 April 2001 with the developer for the office building at a cost of HK\$3.699 billion, which would be charged to EF.

12.6 Members' major concerns about the matter were:

- (a) the need for the purchase and its cost effectiveness;
- (b) the legality of using EF to purchase permanent accommodation for HKMA; and
- (c) the accountability and transparency of HKMA arising from the purchase.

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<sup>17</sup> Legislative Council Panel on Financial Affairs, *Background Brief on Permanent Accommodation for the Hong Kong Monetary Authority*, Meeting on 5 November 2001, LC Paper No. CB(1) 169/01-02 (05).

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### Need and cost-effectiveness of the purchase

12.7 HKMA planned to acquire a total area of 340 000 ft<sup>2</sup> in the new premises, compared to HKMA's current accommodation of around 200 000 ft<sup>2</sup>. According to the Chief Executive of HKMA, HKMA needed more space as it might in the long term take on new duties relating to consumer protection for banking customers, supervision of the deposit insurance system and the Credit Reference Agency, etc. The additional office space would provide purpose-built conferencing facilities, enabling HKMA to provide high quality venue for international conferences and seminars and to provide public access facilities, which would in turn enhance the transparency and accountability of HKMA's operation.

### Legality of using the exchange fund to purchase the premises

12.8 Section 3(1) of EFO stipulates that the primary purpose of EF is to maintain the stability of Hong Kong dollar. Members of the Panel therefore questioned how the acquisition of HKMA's permanent accommodation was related to this purpose. Members had serious doubt on whether "other staff costs" under section 6(a) of EFO could be interpreted to include "cost for accommodation of staff" and hence the cost for the purchase could be met by EF.

12.9 According to the Chief Executive of HKMA, sections 3(1) and (1A) of EFO provide FS with the power to use EF for purposes either directly or indirectly affecting the exchange value of Hong Kong dollar, and for maintaining the stability and integrity of the monetary and financial systems of Hong Kong. Providing HKMA with accommodation and systems for its operation was considered consistent with these purposes.

12.10 In this respect, the Legal Adviser of the Legislative Council Secretariat (LA) advised that against the constitutional requirement that public expenditure had to be approved by LegCo under the Basic Law and the fact that the use of EF to purchase office accommodation for HKMA, which was a government department, was no doubt public expenditure, the reliance on section 6(a) to justify charging that expenditure to EF would need very strong and compelling arguments. To simply argue that "staff costs" meant staff-related costs and therefore covered the cost of accommodating staff might not be conclusive.

12.11 Members agreed at the Panel meeting on 3 May 2001 that the issue should be reviewed upon receipt of details of HKMA's legal advice to FS and the legal advice of the Department of Justice on the matter.

12.12 On 3 September 2001, the FS's Office informed the Panel that FS had taken further advice from the Department of Justice on the matter and on the strength of the advice and for the avoidance of doubt, FS had sought and received the approval for the purchase from CE of HKSAR, under section 6(b) of EFO<sup>18</sup>. According to LA, it was clear that the discretion of CE of HKSAR was quite broad as long as he was prepared to take on the responsibility and political consequential. His exercise of power is, as always, subject to judicial review.

Accountability and transparency of the Hong Kong Monetary Authority arising from the purchase

12.13 Some Members expressed the view that there were insufficient controls over the operation of HKMA under the present legislation and lack of transparency in the management and control of EF. A comprehensive review on the structure and operation of HKMA was considered necessary. In fact, the Administration has been conducting a review to clarify the policy objectives, powers and functions, and the governance and accountability arrangements of HKMA.<sup>19</sup> In replying to our enquiry about the progress of the review, HKMA remarks that it is an ongoing exercise which is likely to continue for some time.

#### Financial control

12.14 HKMA's Internal Audit Division was established in 1995 to assist management in controlling risks, monitoring compliance and improving the efficiency and effectiveness of control systems and procedures within HKMA. In addition, the Audit Sub-Committee of EFAC has been formed to give advice and guidance on audit-related issues. As an external auditor established under the Directive dated 11 December 1993<sup>20</sup>, the Director of Audit audits the accounts of transactions of EF so as to prevent EF from being used for purposes other than those stipulated in EFO. So far, the Director of Audit has not compiled any value for money audit report concerning HKMA. Meanwhile, according to HKMA, the Internal Audit Division has included the value for money audits in its programmes.

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<sup>18</sup> Section 6(b) of EFO provides that any incidental expenditure which the Chief Executive may approve as necessary for the due performance of the duties laid upon FS and the Advisory Committee in connection with the operation of the fund.

<sup>19</sup> At the Panel meeting on 20 April 2001, Members were informed that the Administration had plans to review on the powers and management of HKMA. On 21 November 2001, the Chairman of the Panel wrote a letter to FS enquiring about the progress of the review (see LC Paper No. CB(1)373/01-02). FS made a reply on 14 December 2001 (see LC Paper No. CB(1)610/01-02(01)).

<sup>20</sup> Under the Directive dated 11 December 1993 from the then Governor of Hong Kong made pursuant to section 7 of EFO, it is directed that the accounts of EF "*shall be audited by the Director of Audit who shall certify the signed statement of accounts subject to any report he may think fit to make to the Financial Secretary*". Section 7 of EFO states that "the accounts of all transaction of the Fund shall be audited at such times and in such manner as the Chief Executive [of the Hong Kong SAR Government] may from time to time direct".

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### 13. Staff remuneration arrangements

#### Powers to appoint staff and determine staff remuneration packages

13.1 Under section 5A(1) of EFO, FS shall appoint a person to be MA. Section 5A(3) of EFO states that FS may "*appoint ... persons to assist the Monetary Authority in the performance of the functions of the Monetary Authority specified in subsection (2)*". In practice, FS appoints Executive Directors and above in HKMA while delegating the power to appoint Division Heads and below to MA pursuant to section 5B(1) of EFO, which provides that "*the Financial Secretary may delegate to the Monetary Authority the powers and duties conferred or imposed on the Financial Secretary under this Ordinance*". The current establishment of HKMA is around 580.

#### Process of determining staff's annual remuneration packages

13.2 The existing legislation does not spell out the powers of EFAC in determining the annual remuneration packages for the staff of HKMA, including MA. Section 5A of EFO provides that FS determines the terms and condition of the appointment of MA.

13.3 In practice, FS acts on the advice of EFAC to determine the terms and conditions of the staff of HKMA. The Working Group on Terms and Conditions of Service<sup>21</sup> under EFAC, composing of non-banking EFAC members, was responsible for making recommendations on the annual pay review to EFAC before the determination of any adjustments. The major criteria considered were pay survey results of the local financial sector<sup>22</sup> and the performance of HKMA in the preceding calendar year.<sup>23</sup> In allocating the approved overall pay awards to staff, the performance of individual staff member was taken into account.

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<sup>21</sup> The Working Group on Terms and Conditions of Service was established in 1993 and advised EFAC on the annual pay review of HKMA. The Working Group was recently replaced by the Remuneration and Finance Sub-Committee which is tasked with a broader scope of duties. The Sub-Committee is now responsible for making recommendations to EFAC on pay and conditions of service, human resources policy, and budgetary and administrative issues.

<sup>22</sup> The pay survey is conducted by consultants engaged by HKMA with a view to providing relevant information to EFAC for pay review of each year. The pay survey results are not disclosed to parties outside of EFAC.

<sup>23</sup> This evaluation is made according to assessments of HKMA's achievements in a number of detailed target areas listed under the policy objectives.

### Remuneration structure

13.4 The pay package of HKMA consists of fixed pay, which is basic monthly pay, and variable pay, which may be awarded to individual staff once a year depending on performance. In sum, the pay package of HKMA follows a “total package” concept with minimal benefits in kind.<sup>24</sup>

### Remuneration packages for senior staff

13.5 According to HKMA's 2001 Annual Report, the remuneration packages of the 14 senior staff were as follows:

- (a) Chief Executive: HK\$9,000,001 - HK\$9,500,000;
- (b) three Deputy Chief Executives: HK\$5,500,000 - HK\$7,000,000; and
- (c) ten Executive Directors: HK\$1,000,000 or below - HK\$5,000,000.

13.6 In response to the passage of the LegCo motion on "Reviewing the Pay Adjustment Mechanisms of Statutory Bodies and the Hong Kong Monetary Authority" on 12 December 2001, the Administration commissioned the Hay Group to conduct a review of the remuneration packages for senior executives in 11 selected statutory and public bodies, including HKMA. In parallel, the Administration started an internal review to examine the remuneration of senior executives of other statutory bodies and government-funded organizations.

13.7 According to the report entitled *Review of Remuneration of Senior Executives in Statutory and Other Bodies* issued by Hay Group (Hay Report) in June 2002, the proposed remuneration levels<sup>25</sup> of the Chief Executive, Deputy Chief Executives and Executive Directors of HKMA are HK\$7.25 million, HK\$4.54 million and HK\$2.94 million respectively. When considering the proposed remuneration level for the Chief Executive of HKMA, Hay Group took into account the premium embodied in the remuneration and intangible benefits of the post, including the opportunity to serve Hong Kong, enhanced recognition and honour. The proposed remuneration level was lower than the emolument of the Chief Executive of HKMA in 2001.

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<sup>24</sup> Except for overtime allowance for junior staff, HKMA offers no allowances such as housing allowance, annual leave passage allowance, or local and overseas education allowance.

<sup>25</sup> The comparison group comprises banks, asset management firms and professional services companies.

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### Remuneration of the Exchange Fund Advisory Committee Members

13.8 EFAC members, except MA, do not receive any financial rewards.

## **14. Accountability arrangements**

14.1 Under EFO and BO, MA is responsible to FS through the following arrangements:

- (a) appointment of MA by FS;
- (b) submitting HKMA's annual budget to FS for approval;
- (c) submitting an annual report on the working of BO and the activities of MA during the preceding year to FS; and
- (d) reporting to FS on improvements in the operation and management of HKMA.

14.2 MA reports to LegCo through a number of channels. MA presents the annual report to the Panel usually in May each year. MA also briefs the Panel three times a year on the operations of HKMA and speaks on specific policy issues as and when required.

14.3 The staff of HKMA also attend LegCo meetings as necessary to brief Members on matters of public concern and answer their questions. During 2001, the staff of HKMA attended a total of 45 LegCo Panel and Bills Committee meetings, of which three were regular briefings made by the Chief Executive of HKMA to the Panel. Senior staff of HKMA attended six other Panel meetings to explain to Members various issues including commercial credit reference agency, banking consumer protection, bank mergers and home owners in negative equity. The banking staff of HKMA also attended 11 Bill Committee meetings on the Banking Amendment Bill 2001 and 25 Bill Committee meetings on the Banking Amendment Bill 2002 during the year.

14.4 In addition, LegCo Members can express their views on issues of public concern or call on the Administration to take certain actions through debating motions which do not have legislative effect. (See paragraph 13.6 above for the discussion of the LegCo motion on "Reviewing the Pay Adjustment Mechanisms of Statutory Bodies and the Hong Kong Monetary Authority".)

14.5 HKMA has implemented a number of measures to increase the transparency and accountability of its work, which include:

- (a) improving the quality and accessibility of its publications and website;
- (b) organizing a community education programme;
- (c) increasing the details and frequency of its disclosure of information on EF; and
- (d) publishing the records of meetings of the EFAC Sub-Committee on currency board operations.

14.6 HKMA indicates that it keeps under review improvement of its transparency and accountability.

## **15. Impact of the accountability system for Principal Officials**

### Operational independence

15.1 There is no specific legislation on MA's operational independence.

### Impact of the accountability system

15.2 The Administration implemented a new accountability system for Principal Officials in July 2002. Some LegCo Members have expressed a concern that the accountability system for Principal Officials might affect the governance of HKMA. As the Principal Official for monetary and financial policies, FS becomes a political appointee under the accountability system. As a result, the work of HKMA might be vulnerable to political interference.<sup>26</sup>

15.3 In its reply to our enquiry about the impact of the accountability system, HKMA has stated that the powers and functions of MA are set out clearly in EFO and BO. MA will continue to discharge his duties in accordance with EFO and BO. HKMA does not expect that the new accountability system will affect its operations and cause any exertion of political influence over its work. Hence, there is no plan to conduct a special review on this issue.

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<sup>26</sup> Legislative Council Panel on Financial Affairs, *Minutes of Meeting Held on 5 May 2002*, LC Paper No. CB(1) 2289/01-02, paragraphs 29 - 31.

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### **Part 3 - Office of the Telecommunications Authority, Hong Kong**

#### **16. Powers and functions of the Office of the Telecommunications Authority**

16.1 The Telecommunications Ordinance (Cap. 106) stipulates the appointment of the Telecommunications Authority (TA) as the public officer to oversee the regulation of the telecommunications sector. TA is appointed by the Chief Executive of Hong Kong Special Administrative Region (CE of HKSAR). The Office of the Telecommunications Authority (OFTA) was established on 1 July 1993 as the executive arm of TA by hiving off the then Telecommunications Branch of the Post Office to become an independent government department.

16.2 The role of OFTA is to regulate and facilitate the development of the telecommunications sector of Hong Kong. Its major functions are:

- (a) carrying out economic and technical regulation of the telecommunications industry;
- (b) enforcing fair competition rules;
- (c) setting technical standards;
- (d) co-ordinating the development of telecommunications infrastructures;
- (e) investigating consumer and industry complaints;
- (f) managing the radio spectrum;
- (g) licensing telecommunications services, networks, systems and installations; and
- (h) facilitating the interconnection and shared use of telecommunications facilities where appropriate.

## **17. Organizational structure**

17.1 OFTA is a government department; hence, it does not have a management board to oversee its operations. In practice, TA is the de facto head of OFTA as he is concurrently appointed as the Director-General of Telecommunications (DG Tel). DG Tel is responsible for overseeing the overall management of OFTA and carrying out the statutory functions of TA. He is assisted by the Deputy Director-General of Telecommunications (DDG) who oversees the four branches in OFTA, namely the Regulatory Affairs Branch, the Competition Affairs Branch, the Operations Branch and the Support Branch. Each of these four branches is headed by an Assistant Director.

17.2 Under the recent implementation of the accountability system for Principal Officials, DG Tel is accountable through the Permanent Secretary for Commerce, Industry and Technology (Information Technology and Broadcasting) to the Secretary for Commerce, Industry and Technology (SCIT). (See Appendix II for the organizational structure of OFTA.)

17.3 A regular forum is in place whereby senior staff of OFTA meet on a weekly basis to review the operations of the four branches, discuss strategic issues and provide directives for steering of departmental programmes. Standing members of the forum include DG Tel, DDG, the four Assistant Directors and the Senior Legal Advisor, while other senior officers will be called upon to attend the meetings on a need basis.

17.4 A regular monthly management meeting is also held and chaired by DG Tel to discuss operational issues. The meeting is attended by all senior directorate staff, all division heads, the Senior Legal Advisor, the Head of the IT Section and the Head of the Enforcement Section.

### Advisory committees

17.5 OFTA regularly convenes meetings with various advisory committees consisting of members of the public, industry professionals and representatives from other government departments on matters of shared concerns. These advisory committees include the Radio Spectrum Advisory Committee, the Telecommunications Numbering Advisory Committee, the Telecommunications Standards Advisory Committee, and the Telecommunications Users and Consumers Advisory Committee.



## **18. Funding of the Office of the Telecommunications Authority**

### Government appropriation

18.1 The OFTA Trading Fund was established on 1 June 1995 under the Trading Funds Ordinance (Cap. 430). The resolution, which provided for the establishment of the OFTA Trading Fund, also approved an appropriation of HK\$214 million of fixed assets to the Trading Fund. The appropriation came from the Capital Investment Fund, which represented the Administration's investment in the OFTA Trading Fund.

18.2 As a trading fund department, all revenue generated by services provided by OFTA to both the private and public sectors is accrued to the Trading Fund. All expenditure incurred by OFTA in providing its services is paid out of the Trading Fund. Under the Trading Funds Ordinance, OFTA could borrow from the Capital Investment Fund or the Loan Fund upon the approval of the Finance Committee (FC) of LegCo, or by way of temporary overdraft facilities in the matter and up to the limit as approved by the Financial Secretary (FS). Since its inception in 1995, the OFTA Trading Fund has not requested any additional funding from the Administration.

### Sources of income

18.3 OFTA derives most of its revenue from licence fees, which accounted for HK\$274.9 million or 90.9% of its total revenue in Financial Year<sup>27</sup> 2001-02. The Telecommunications Ordinance prescribes the types and amount of licence fees charged by OFTA. The Ordinance also stipulates the authority of SCIT to adjust licence fees subject to the approval of LegCo.

18.4 OFTA transfers to a development reserve its operating surplus in excess of the target return set by the Administration. The development reserve can be drawn upon to reduce the magnitude of future fee increases or to meet future expansion of OFTA's activities. For Financial Year 2001-02, OFTA's accumulated development reserve amounted to HK\$555.2 million.

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<sup>27</sup> Financial Year begins on 1 April and ends on 31 March of the following year.

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## **19. Mechanism for approving and controlling expenditure**

### Budgetary process

19.1 Under the Trading Funds Ordinance, OFTA is required to prepare each year an Annual Business Plan for approval by the Administration. The Annual Business Plan sets out OFTA's plans for the upcoming financial year, including budgeted expenditure and revenue estimates, as well as financial and performance targets. The Plan is vetted first by the Financial Services and the Treasury Bureau (FSTB), and then by the Commerce, Industry and Technology Bureau (CITB). Formal approval is given by SCIT after the Secretary for Financial Services and the Treasury has endorsed all the financial aspects. OFTA must incur expenditure in accordance with the approved Annual Business Plan. The same approval procedure is adopted for capital expenditure.

### Controlling of expenditure

19.2 The total expenditure of OFTA amounted to HK\$262.3 million in Financial Year 2001-02, with HK\$215.9 million or 82.3% being staff costs. OFTA's capital expenditure amounted to HK\$56.5 million in Financial Year 2001-02.

19.3 The approval of DG Tel is required for any unbudgeted expenditure, which includes any over-spending over the budgeted amount stated in the Annual Business Plan. The unbudgeted expenditure has to be captured in the Revised Budget which is prepared annually in September/October to reflect the latest resource requirements. In addition, the OFTA Trading Fund must submit its financial statements to the Director of Audit for audit at the end of each financial year.

## **20. Remuneration for staff**

20.1 DG Tel has been delegated with the authority to determine the non-directorate establishment of OFTA. For the creation, redeployment and deletion of posts remunerated at the directorate pay scales, like all other government departments, the approval from FC of LegCo is required. OFTA employed a staff of 343 people in August 2002, with 250 serving on civil service terms and 93 on non-civil service contract terms.

20.2 The remuneration packages for contract staff are determined by an internal committee consisting of all senior directorate staff, based upon factors such as the prevailing market pay level for similar jobs, qualifications and experiences of the new appointees as well as their current salary position.

20.3 The remuneration packages for contract staff are reviewed annually and upon renewal of contract. The review is based on the performance of the staff concerned and the prevailing market conditions.

## **21. Accountability arrangements**

21.1 Like other government departments, OFTA is accountable to the head of its policy bureau, SCIT, for telecommunications policies.

21.2 As a trading fund department, OFTA is subject to accountability arrangements stipulated in the Trading Funds Ordinance and the Framework Agreement between DG Tel and SCIT<sup>28</sup>. In particular, OFTA is required to:

- (a) achieve a reasonable rate of return on its average net fixed assets;
- (b) submit to FS its audited financial statements and an annual report on the operations of the Trading Fund;
- (c) prepare an Annual Business Plan and a Medium Range Corporate Plan setting out the short and long term strategies and targets for achieving the business and policy objectives; and
- (d) explain to CITB and FSTB any major budget variance against the Annual Business Plan.

21.3 OFTA is answerable to LegCo through a number of channels:

- (a) answering questions raised by LegCo Members at Council meetings;
- (b) briefing relevant Panels and Bills Committees on issues of public concerns and major legislative or financial proposals before their formal introduction into the Council or FC; and
- (c) tabling in Council audited financial statements and an annual report on the operations of its trading fund.

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<sup>28</sup> The Framework Agreement between SCIT and the General Manager of the OFTA Trading Fund sets out the relationship between the two, particularly their respective roles and responsibilities. DG Tel is concurrently appointed as the General Manager of the OFTA Trading Fund.

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21.4 OFTA keeps the public informed of its operations, policies and the progress of individual telecommunications issues through the posting of relevant papers and documents on its website. OFTA also conducts community education programmes and other community services to promote the public awareness of the benefits of new telecommunications services. In addition, DG Tel writes a weekly column in a local newspaper to express his views on topical telecommunications issues.

21.5 OFTA conducts public consultation to solicit the views of the telecommunications operators and other interest groups on major policy issues.

21.6 TA's decisions could be subject to judicial review initiated by the telecommunications operators concerned. In addition, the Telecommunications (Competition Provisions) Appeal Board was established in 2000 to handle appeals against TA's decision on issues relating to the competition among telecommunications operators.

## **22. Impact of the accountability system for Principal Officials**

### Operational independence

22.1 There is no specific legislation on OFTA's operational independence.

### Impact of the accountability system

22.2 The Administration implemented a new accountability system for Principal Officials in July 2002. So far OFTA has not made any assessment on the system. OFTA will continue to discharge its functions within the powers set out in the Telecommunications Ordinance.

## **Part 4 - Trade and Industry Department, Hong Kong**

### **23. Powers and functions of the Trade and Industry Department**

23.1 Like most other government departments, the legal powers of the Trade and Industry Department<sup>29</sup> (TID) to carry out all of its duties are conferred upon its head, the Director-General of Trade and Industry (the Director-General).

23.2 The major functions of TID are:

- (a) handling the Hong Kong Special Administrative Region's (HKSAR's) commercial relations with its trading partners;
- (b) implementing trade policies and agreements, including the issue of certificates of origin and export and import licences;
- (c) participating in international trade fora; and
- (d) providing general support services for the industrial sector and small and medium enterprises (SMEs).

### **24. Organizational structure**

24.1 The Director-General is assisted by two Deputy Directors-General, who respectively heads the Multilateral, Regional Co-operation and Europe Group, and the Commercial Relations, Controls and Support Group. They are supported by seven Assistant Directors-General, each heading a division. (See Appendix III for the organizational structure of TID.)

24.2 Under the recent implementation of the accountability system for Principal Officials, the Director-General is accountable through the Permanent Secretary for Commerce, Industry and Technology (Commerce and Industry) to the Secretary for Commerce, Industry and Technology. (See paragraph 28.1 for the accountability arrangements.)

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<sup>29</sup> In July 2000, a reorganization took place in the former Trade Department and the former Industry Department. The Trade Department was re-titled the Trade and Industry Department which took over the disestablished Industry Department to increase synergy and provide more efficient one-stop services for businesses in the trade and industrial sectors.

### Advisory boards and committees

24.3 The Director-General is advised by the Trade and Industry Advisory Board (TIAB), the Textiles Advisory Board (TEXTAB), the Rice Advisory Committee (RAC) and the Small and Medium Enterprises Committee (SMEC).

- (a) TIAB advises on matters affecting Hong Kong's trade and industrial sectors, other than the textiles and garment industries.
- (b) TEXTAB advises on issues, other than labour matters, which relate to the textiles and garment industries.
- (c) RAC advises on the operation of the Rice Control Scheme and all aspects of the rice trade.
- (d) SMEC advises on issues affecting the development of SMEs in Hong Kong and suggests measures to support and facilitate their development and growth.

## **25. Funding of the Trade and Industry Department**

25.1 As a government department, TID's expenditure is met directly by the General Revenue Account.

### Fees and charges levied by the Trade and Industry Department

25.2 TID levies fees and charges on its services, including applications for and issue of certificates of origin, export licences and transfer of quotas, and subscription to trade circulars. Amendments to fees and charges require the approval of the Legislative Council (LegCo) by resolution.

25.3 Revenues from fees and charges levied by government departments, such as TID, are credited to the General Revenue Account. In Financial Year<sup>30</sup> 2001-02, revenues from fees and charges levied by TID totalled HK\$203.3 million.

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<sup>30</sup> Financial year begins on 1 April and ends on 31 March of the following year.

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## **26. Mechanism for approving and controlling expenditure**

### Procedures of approving the budget

26.1 The Director-General of TID is responsible for preparing the draft annual departmental budget, which is submitted to the Commerce, Industry and Technology Bureau (CITB) for consideration. CITB may amend the draft in the light of the general policies and priorities of the Administration and resources available. The draft is then submitted to the Financial Secretary (FS) for incorporation into the Government's budget.

26.2 The budget is presented to LegCo in the form of an Appropriation Bill. Following the moving of the Second Reading of the Bill, debate is adjourned, and the estimates containing details of the financial requirements in the Bill are referred to the Finance Committee<sup>31</sup> (FC) for scrutiny.<sup>32</sup> After FC has completed detailed examination of the estimates, the debate on the Second Reading of the Bill is resumed. If the Second Reading is supported, the Bill will proceed to committee stage and then the Third Reading stage.

26.3 Where variations to the approved estimates are found necessary in the middle of the financial year, financial proposals may be put to FC for consideration and approval. The final account with modification after taking into account of the variations and actual expenditure is submitted to LegCo for endorsement in the context of the Appropriation (Supplementary) Bill. Public expenditure proposals not covered in the Appropriation Bill are scrutinized and approved by FC.

### Controlling of expenditure

26.4 The estimated expenditure of TID amounts to HK\$1.04 billion for Financial Year 2002-03. Personal emolument totals HK\$262.9 million for Financial Year 2002-03, accounting for 25.3% of the total estimated expenditure. TID's capital expenditure amounts to HK\$726.1 million for Financial Year 2002-03.

26.5 As a government department, where a capital project falls within the portfolio of Public Works Reserve Fund, any projects exceeding HK\$10 million requires FC's approval and the approval of the Financial Services and the Treasury Bureau under FC's delegated authority for projects below HK\$10 million.

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<sup>31</sup> FC holds special meetings to examine the Draft Estimates of Expenditure to ensure that the provision sought is no more than is necessary for the execution of approved policies.

<sup>32</sup> TID received five questions related to its work area at special FC meetings in 2002.

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26.6 The Director-General of TID is the controlling officer of Head 181 Trade and Industry Department. He is responsible and accountable for all expenditure and government properties in respect of the Department and services for which he is responsible. In each year's estimates, he outlines the distribution of spending on his programme areas and specifies his intended results.<sup>33</sup> The effectiveness or cost-effectiveness of the results is measured where possible in terms of unit cost or productivity indicators.

26.7 The accounts of TID, similar to other government departments, are audited by the Director of Audit.

## **27. Remuneration for staff**

27.1 All staff in TID are civil servants. They are employed to perform the functions of the department. In March 2002, the establishment in TID was 734.

27.2 Since TID is a government department, the determination of and adjustment to the terms of employment for staff in TID are subject to civil service pay and grading policies, adjustment systems and mechanism.

## **28. Accountability arrangements**

28.1 The Director-General of TID is accountable through the Permanent Secretary for Commerce, Industry and Technology (Commerce and Industry) to the Secretary for Commerce, Industry and Technology for the implementation of TID's programmes.

28.2 TID is answerable to LegCo through a number of channels:

- (a) answering questions raised by LegCo Members at Council meetings;
- (b) briefing relevant Panels and Bills Committees; and
- (c) seeking the approval of public funding.

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<sup>33</sup> Activities of the Administration are assigned to different programmes, which are drawn up stating the policy objectives, a forecast of demand and the size of provisions needed to meet the objectives.

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28.3 For the public, TID puts in place a variety of channels, such as:

- (a) promulgating performance targets for service items;
- (b) offering a 24-hour enquiry hotline;
- (c) providing information on its website; and
- (d) handling complaints about TID.

## **29. Impact of the accountability system for Principal Officials**

### Operational independence

29.1 There is no specific legislation on TID's operational independence.

### Impact of the accountability system

29.2 The Administration implemented a new accountability system for Principal Officials in July 2002. So far TID has not made any assessment on the system. TID will continue to discharge its functions within the powers and authority of the Director-General.

## **Part 5 - Housing Department, Hong Kong**

### **30. Powers and functions of the Housing Department**

30.1 The Housing Ordinance (Cap. 283) establishes the Housing Authority (HA) as a statutory body responsible for implementing Hong Kong's public housing programme. HA carries out its functions through its executive arm, the Housing Department (HD).

30.2 HA will undergo a structural change following the release of the report entitled *Review of the Institutional Framework for Public Housing* (the Review)<sup>34</sup> by the Chief Secretary for Administration (CS) on 20 June 2002. The Review proposes, among other things, a gradual change of HA from an executive to an advisory body. It also recommends that HD and its former policy bureau, the Housing Bureau (HB), should be re-organized into a single housing organization with a unified chain of command. On 1 July 2002, the new housing organization was formed with the merger of HD and HB. This new organization, which comes under the new Housing, Planning and Lands Bureau (HPLB), retains the name of "Housing Department". The new HD will continue to serve as the executive arm of HA until the latter divests itself of its executive function.

30.3 For the purpose of this study, it would not be meaningful to look at HD's governance based on the Administration's new housing framework. As mentioned in the Introduction of this report, the former HD was chosen because of its financially autonomous status while maintaining a government structure. Indeed, it is this organizational structure that makes it meaningful to compare the governance of the Hong Kong Monetary Authority with that of the former HD. As such, the study of HD's governance below will be based on its organizational structure before 1 July 2002.

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<sup>34</sup> The review was commissioned in June 2000 when the Chief Executive of the Hong Kong Special Administrative Region established the Committee on the Review of the Institutional Framework for Public Housing, chaired by CS, to review and reform the organizations responsible for delivering the public housing programme in Hong Kong. The establishment of the Committee was in response to the public concern over a number of serious incidents affecting the quality of public housing developments.

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- 30.4 As the executive arm of HA, HD performed the following major functions:
- (a) serving as the major public housing executive agency;
  - (b) planning and developing public housing and commercial facilities;
  - (c) undertaking building control functions;
  - (d) allocating and marketing public housing and commercial facilities;
  - (e) providing home ownership loans; and
  - (g) undertaking clearance operations and squatter control as the Administration's agent.

### **31. Organizational structure**

31.1 Headed by the Director of Housing, HD followed the structure of HA to operate along four business lines. In addition, there were also two cross-business supporting services branches at HD. Each of these branches was headed by a Director responsible for developing and overseeing daily operations of his branch, setting service goals and performance standards, and monitoring resource allocation within his branch.

31.2 There were two other divisions within HD, namely the Director's Office and the Corporate Strategy Unit. The Director's Office consisted of the Technical Audit Unit, the Internal Audit Unit and the Independent Checking Unit. The Corporate Strategy Unit was responsible for, among other things, formulating strategies on public housing development, preparing HD's Corporate Plan<sup>35</sup>, and conducting statistical research and analysis. (See Appendix IV for the organizational structure of HD prior to 1 July 2002.).

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<sup>35</sup> Since 1997, HA had put in place a corporate planning process to facilitate forward planning in achieving its strategic objectives. Under this planning process, a strategic plan known as Corporate Plan was drawn up to set out the corporate objectives and key initiatives for the upcoming financial year.

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### Executive Board

31.3 At the top of the management structure, there was an Executive Board, which consisted of all senior directorate staff and unit heads responsible for corporate strategies and information dissemination. The functions of the Executive Board were:

- (a) advising HA on strategic policy issues;
- (b) formulating and reviewing major housing policies;
- (c) co-ordinating and resolving cross-branches issues;
- (d) considering the corporate and business plans of HA and monitoring their implementation;
- (e) monitoring the overall operations of HD; and
- (f) overseeing financial and manpower planning within HD.

## **32. Funding of the Housing Department**

32.1 As the executive arm of HA, HD undertook the services of HA with the expenditure so incurred fully funded by HA.

32.2 HA also undertook certain functions as the Administration's agent<sup>36</sup>. For such functions, funding came directly from the Government's General Revenue Account in the context of the estimates approved by the Legislative Council (LegCo). HA, being a financially autonomous body, received public subsidy in the form of concessionary land grants as well as interest-bearing loan capital. Pursuant to the 1988 Financial Arrangements and the subsequent Supplemental Agreement with the Government in 1994, cash balances of HK\$2.8 billion transferred from the former Home Ownership Fund and capital injection of HK\$10 billion by the Administration between 1988 and 1993 were both converted into interest-bearing loan capital with effect from 1 October 1994. HA was required to repay the Administration the loan capital in quarterly instalments at 5% interest per annum over a period of 14 years. Since then, there was no further requirement for capital injection from the Administration.

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<sup>36</sup> Pursuant to the 1988 Financial Arrangements with the Government, HD continued to undertake certain functions, such as squatter control, improvements to squatter areas and the clearance of squatters on land required for development, on an agency basis for the Administration. As these agency functions were provided on behalf of the Administration, and not HA, the related expenditure incurred was fully reimbursed by the Administration.

32.3 HA's recurrent revenue was derived principally from the sale of subsidized home ownership flats, and rental income from public housing and commercial premises. For Financial Year<sup>37</sup> 2001-02, HA received HK\$20.1 billion or 58.7% of its total income from the sale of subsidized home ownership flats. Rental income accounted for another HK\$13.9 billion or 40.5% of HA's total income in the year.

### **33. Mechanism for approving and controlling expenditure**

#### Budgetary process

33.1 HD's budget was prepared as an integral part of the corporate and business planning process of HA. Under this process, each Business Director produced a business plan, which included budget proposals, for discussion and endorsement by the respective Business Committee. The budget proposals were then consolidated for submission to members of HA for approval. Thereafter, as required by the Housing Ordinance, the HA's budget would be submitted to the Chief Executive of the Hong Kong Special Administrative Region (CE of HKSAR) for final approval.

33.2 As for capital expenditure, it followed the same approval procedure as that for operating expenditure. LegCo's approval was required if HA sought any funding/borrowing from the Administration. For example, HA proposed to construct its own Headquarters building in November 1985. Approval of the Finance Committee of LegCo for granting of a HK\$264.1 million loan from the Administration's Development Loan Fund for the construction was sought and given in July 1986. However, if the capital expenditure had been funded by internal financial resources, there would have not been any need for HA to seek LegCo's approval.

#### Controlling of expenditure

33.3 HA's capital expenditure amounted to HK\$13.3 billion in Financial Year 2001-02. Meanwhile, HA's recurrent expenditure (excluding capital expenditure and Home Ownership Scheme related payments) and personal emoluments amounted to HK\$16.1 billion and HK\$3.6 billion respectively over the same year.

33.4 HA was required to produce financial statements for submission to the Director of Audit.

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<sup>37</sup> Financial Year began on 1 April and ended on 31 March of the following year.

## **34. Remuneration for Housing Authority members and Housing Department staff**

### Remuneration for Housing Authority members

34.1 With the exception of the HA Chairman, the non-official members of HA did not receive any remuneration. The Chairman of HA was remunerated at 50% of the salary of a D8 officer in the civil service.

### Remuneration for Housing Department staff

34.2 HA, through HD, employed staff to perform its functions. The vast majority of HA's staff were civil servants on loan from the Administration, and their remuneration packages and adjustments were thus in conformity with the civil service pay policy and adjustment mechanism. HA had an establishment of 12 816 in June 2002, of which 10 910 were civil servants. The remaining 1 906 were employed by HA on contract terms.

## **35. Accountability arrangements**

35.1 HA was required to submit an annual report and statements of accounts at the end of each financial year to CE of HKSAR. In addition, CE of HKSAR could give such directions as he deemed fit, either generally or in any particular case, with respect to the exercise or performance by HA or a public officer, of any power, functions or duties under the Housing Ordinance.

35.2 HD reported to HA as it was the latter's executive arm. HD also worked as the agent for HB in squatter control and clearance.

35.3 Through HB, HD was answerable to LegCo through a number of channels:

- (a) answering questions raised by LegCo Members at Council meetings;
- (b) briefing relevant Panels and Bills Committees; and
- (c) reporting its performance in HA's financial statements and annual report which were tabled before LegCo.

35.4 HD had kept the public informed of its operations and policies through the production of a wide variety of publications and community education materials, which ranged from regular newsletters to pamphlets and videos. HD also maintained a website to provide a variety of information to the general public.

## **36. Impact of the accountability system for Principal Officials**

36.1 One of the important features of the accountability system is that the Principal Officials will conduct a review of the working relationship between policy bureaux and the executive departments falling within their portfolios. The overall direction of the review is to streamline administrative structures, merge and integrate similar functions, make better use of resources, and enhance the efficiency of policy implementation and delivery of services to the general public.

36.2 The merger of HB and HD into a new housing organization (the Housing Department) was the first of such moves between a policy bureau and its executive department since the implementation of the accountability system. The new organization, which comes under the direction of the Secretary for Housing, Planning and Lands, integrates both the policy formulation and implementation under the same roof. The organizational structure for this new housing organisation as proposed in the Review is depicted in Appendix V.

## **Part 6 - Securities and Futures Commission, Hong Kong**

### **37. Powers and functions of the Securities and Futures Commission**

37.1 The Securities and Futures Commission Ordinance (SFCO) (Cap. 24) of Hong Kong was enacted in 1989 to provide for the regulatory framework to establish the Securities and Futures Commission (SFC) as a statutory body to regulate the securities and futures industry. In particular, SFCO transferred the functions of the former Securities Commission, the Commodities Trading Commission, and the Office of the Commissioner for Securities and Commodities Trading to SFC upon its establishment on 1 May 1989.

37.2 On 13 March 2002, the Legislative Council (LegCo) passed the Securities and Futures Ordinance (SFO), with the intention to consolidate and modernize SFCO and nine other pieces of securities and futures legislation written over the past 25 years. Since then, the Government, LegCo and the concerned parties have involved in the drafting and consultation of related subsidiary legislation. According to the Secretary for Financial Services and the Treasury, the target commencement date for SFO is set at 1 April 2003.

37.3 Under section 5 of SFO, the statutory functions of SFC are:

- (a) maintaining and promoting the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry;
- (b) promoting the understanding by the public of the operation and functioning of the industry;
- (c) minimizing crime and misconduct in the industry;
- (d) assisting the Financial Secretary (FS) in maintaining the financial stability of Hong Kong by taking appropriate steps in relation to the industry;
- (e) reducing systemic risks in the industry; and
- (f) providing protection for members of the public investing in or holding financial products.



## **38. Organizational structure**

### The Board of Directors

#### *Functions*

38.1 SFC's Board of Directors (the Board) is responsible for formulating SFC's overall policy and strategy, as well as overseeing its management and operations.

#### *Membership of the Board*

38.2 Under SFCO, the Chief Executive of the Hong Kong Special Administrative Region (CE of HKSAR) appoints (i) a Chairman and (ii) uneven number of other directors (no fewer than seven) to SFC. SFCO also stipulates that half of the Directors (including the Chairman) are appointed as Executive Directors and the rest as Non-executive Directors. At present, the Chairman of SFC and four other Executive Directors, together with six Non-executive Directors, sit on the Board<sup>38</sup>. The Non-executive Directors currently consist of a lawyer, a LegCo Member, two company directors, an accountant and the Chairperson of the Equal Opportunities Commission.

38.3 The composition of the Board will be changed after the implementation of SFO, as the new Ordinance requires that there must be no fewer than eight members on the Board and that the majority must be Non-executive Directors.

#### *Appointment*

38.4 The Chairman and the Deputy Chairman of SFC are appointed by CE of HKSAR, who has delegated authority to FS to make appointments of other Executive and Non-executive Directors.

38.5 There is no statutory provision for the tenure of Executive and Non-executive Directors. Under SFO, CE of HKSAR may remove any Director from office should the removal appear to him desirable for the effective performance of SFC's functions.

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<sup>38</sup> The Board should contain one more Executive Director member, the Deputy Chairman of SFC, but the post for the Deputy Chairman is currently vacant.

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### Advisory Committee

38.6 The Advisory Committee is a statutory body established under SFO. It meets at least once every three months to advise SFC on policy matters and the performance of its functions. In addition, SFO stipulates that the Advisory Committee should comprise:

- (a) the Chairman of SFC;
- (b) no more than two other Executive Directors of SFC; and
- (c) no fewer than eight (but no more than 12) other members who are appointed by CE of HKSAR after consultation with SFC.

### Management structure

38.7 Each of the four Executive Directors heads an operational division and is directly responsible for the work of the respective division. The four operational divisions are Corporate Finance, Intermediaries and Investment Products, Enforcement, and Supervision of Markets. There are also supporting divisions and departments which provide legal, technology, research, public relations, finance, personnel and administrative services. (See Appendix VI for the organizational structure of SFC.)

## **39. Funding of the Securities and Futures Commission**

39.1 SFC currently derives its funding from two main sources, namely:

- (a) levies on transactions recorded on the stock and futures markets; and
- (b) fees and charges for services provided to market participants.

39.2 In fact, SFC is also entitled to receive in each financial year an annual recurrent government grant paid out of the General Revenue Account appropriated by the Finance Committee (FC) of LegCo<sup>39</sup>. Nevertheless, SFC has not requested any government appropriation since 1993-94. The revenue from levies, fees and charges has been sufficient to meet SFC's expenditure except in Financial Year<sup>40</sup> 2001-02, when internal financial reserves had to be deployed to finance the deficit of its budget resulting from a low turnover of transactions.

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<sup>39</sup> The appropriations from LegCo serve to provide SFC with a stable source of income to offset the more volatile income from levies, fees and charges.

<sup>40</sup> Financial Year begins on 1 April and ends on 31 March of the following year.

39.3 There is an emergency fall-back mechanism whereby SFC can seek loans with the approval of FC of LegCo to enable it to survive any exceptionally prolonged period of low market activities.

#### Sources of income

39.4 SFC derives its income from the following sources:

- (a) Levies on transactions amounted to HK\$202.6 million in Financial Year 2001-02 or 55.8% of SFC's total income. SFO provides for CE of HKSAR in Council to adjust the rates of transaction levies subject to the approval of LegCo;
- (b) Fees and charges amounted to HK\$117.5 million or 32.4% of SFC's total income in Financial Year 2001-02; and
- (c) Investment income from SFC's holding of debt securities amounted to HK\$41.4 million or 11.4% of the total income in Financial Year 2001-02. In that year, SFC also received HK\$1.5 million from other revenue sources, including sales of its publications, legal costs recovered and investigation costs awarded.

### **40. Mechanism for approving and controlling expenditure**

#### Budgetary process

40.1 SFC must submit its annual estimates of income and expenditure to CE of HKSAR for approval. Since 1995, the authority for approving SFC's annual budget has been delegated to FS. Before the submission of the budget to FS, the income/expenditure estimates must be thoroughly examined by SFC's Budget Committee, which is chaired by a Non-executive Director, and endorsed by the full board of Directors.

40.2 As for capital expenditure, it follows the same approval procedure as that for operating expenditure.

#### Controlling of expenditure

40.3 The total expenditure of SFC amounted to HK\$417.1 million in Financial Year 2001-02, of which staff costs and capital expenditure amounted to HK\$313.4 million and HK\$26.8 million respectively. For any expenditure which exceeds the budgeted amount by more than 10%, prior approval from FS must be sought.

40.4 SFO requires SFC to prepare true and fair financial statements, which are audited by an independent external auditor.

#### **41. Remuneration for Directors and staff**

##### Remuneration for Chairman and other Directors

41.1 SFC's Directors are entitled to such terms and conditions of office as CE of HKSAR may, from time to time, determine pursuant to SFO. At present, all Executive Directors are remunerated, while Non-executive Directors receive an honorarium.

41.2 The remuneration packages for Executive Directors comprise a fixed pay and a performance-related bonus<sup>41</sup>. For Financial Year 2001-02, the remuneration packages for the Chairman and Executive Directors were HK\$6.5-\$7 million and HK\$4-\$4.5 million respectively.

41.3 As for Non-executive Directors, the amount of honorarium is determined by CE of HKSAR based upon, among other factors, the time required to be spent on SFC affairs in relation to that of Non-executive Directors in similar agencies. As at June 2002, each Non-executive Director received an average of HK\$234,000 per annum.

##### Remuneration for staff

41.4 SFC can employ staff and engage consultants, agents and advisers to assist in performing its functions. As at June 2002, the permanent and temporary staff members at SFC stood at 350 and 55 respectively. SFO also provides that SFC can determine remuneration, allowance, and other conditions of employment of its non-directorate staff.

41.5 The remuneration packages for SFC's staff other than Executive Directors are determined by the Board based on recommendations made by the Remuneration Committee, an internal committee chaired by a Non-executive Director to oversee staff salaries and benefits.

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<sup>41</sup> The fixed pay is constant throughout the contract period, whereas the variable bonus is awarded annually on a performance basis and subject to a cap stipulated in each individual contract.

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### Comparability with other bodies

41.6 According to the report entitled *Review of Remuneration of Senior Executives in Statutory and Other Bodies* issued by the Hay Group Limited (Hay Report) in June 2002, the proposed remuneration levels<sup>42</sup> of the Chairman and Executive Directors of SFC are HK\$7,033,000 and HK\$4,219,000 respectively. SFC stated that the pay levels for these posts are all in line with the proposed ranges of remuneration. Furthermore, SFC would consider the findings of the Hay Report and make improvements where appropriate.

## **42. Accountability arrangements**

42.1 SFO requires SFC to report regularly to FS. In practice, SFC mainly reports to the Financial Services Branch of the Financial Services and the Treasury Bureau on matters relating to the securities and futures industry. As such, SFC is accountable to both FS and the Secretary for Financial Services and the Treasury.

42.2 The major accountability arrangements between the Administration and SFC are:

- (a) the appointments of SFC's Directors require the approval of CE of HKSAR, who has delegated his power to FS to make most of the appointments;
- (b) the annual budget of SFC requires the approval of FS;
- (c) SFC is required to submit its audited financial statements to FS after the end of each financial year; and
- (d) the internal operations of SFC are subject to scrutiny by the Process Review Panel<sup>43</sup>, whose report to FS is made public.

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<sup>42</sup> The comparison group comprises banks, asset management firms and professional services companies.

<sup>43</sup> The Process Review Panel is an independent body established by CE of HKSAR to review the internal operational procedures of SFC and to determine whether SFC has followed these procedures.

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42.3 SFC is answerable to LegCo through:

- (a) answering questions raised by LegCo Members at Council meetings;
- (b) briefing relevant Panels and Bills Committees on issues of public concern and major legislative or financial proposals before their formal introduction into the Council or FC; and
- (c) tabling its approved budgets, annual reports and audited financial statements in LegCo.

42.4 There is a public redress mechanism which allows the public to:

- (a) complain to an independent tribunal<sup>44</sup> against decisions made by SFC relating to the registration, regulation and discipline of intermediaries; and
- (b) seek judicial review of SFC's decision.

42.5 SFC initiates public consultations to solicit the views of the securities and futures industry and other interest groups on major policy issues. SFC also keeps the public informed of its operations, policies and financial performance through the posting of relevant reports, papers and other documents<sup>45</sup> on its website.

42.6 SFC conducts community education programmes and other community services to educate investors of potential market misconduct and ways of protecting their rights.

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<sup>44</sup> Currently, the Securities and Futures Appeals Panel serves as the independent tribunal. The Panel is to be replaced by the Securities and Futures Appeals Tribunal, which will be established under SFO with greater power to overrule SFC's decisions.

<sup>45</sup> For example, SFC has strengthened communications with the public and the securities and futures industry by the publication of a quarterly report on its operations and financial performance since August 2001. In October 2001, SFC also launched a monthly newsletter, the SFC Alert, which targets at investors and intermediaries.

**43. Impact of the accountability system for Principal Officials**

Operational independence

43.1 There is no specific legislation on SFC's operational independence.

Impact of the accountability system

43.2 The Administration implemented a new accountability system for Principal Officials in July 2002. So far SFC has not made any assessment on the system. SFC will continue to discharge its functions within the powers set out in SFO.

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## Part 7 - Mandatory Provident Fund Schemes Authority, Hong Kong

### 44. Powers and functions of the Mandatory Provident Fund Schemes Authority

44.1 The Mandatory Provident Fund Schemes Ordinance (MPFSO) (Cap. 485), which was enacted in August 1995, provides the framework for the establishment of a privately-managed mandatory provident fund (MPF) system. MPFSO was amended in March 1998 and supplemented by regulations enacted between 1998 and 2000, setting out the detailed rules governing the operation of the MPF system and exemption of members covered by certain occupational retirement schemes. The MPF legislation was further amended in 2002 to enhance the effectiveness and efficiency of the MPF system.

44.2 Under section 6 of MPFSO, the Mandatory Provident Fund Schemes Authority (MPFA) was established in September 1998 to regulate, supervise and monitor the operation of the MPF system. MPFA came into operation in December 2000.

44.3 Under section 6E of MPFSO, the major functions of MPFA are:

- (a) ensuring compliance with MPFSO;
- (b) registering MPF schemes<sup>46</sup>;
- (c) approving qualified persons and companies to be trustees of registered schemes;
- (d) regulating the affairs and activities of approved trustees and ensuring as far as reasonably practicable that these trustees administer the registered schemes in a prudent manner;
- (e) making rules or guidelines for the effective administration of MPF schemes;
- (f) considering and proposing reforms of the legislation relating to occupational retirement schemes<sup>47</sup> or provident fund schemes; and
- (g) promoting and encouraging the development of retirement schemes in Hong Kong.

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<sup>46</sup> MPFA is also responsible for administering the Compensation Fund to compensate any MPF scheme member who has beneficial interests in MPF schemes for any loss in MPF accrued benefits caused by misfeasance or illegal conduct committed by MPF trustees or any other persons engaged in the administration of MPF schemes.

<sup>47</sup> MPFA took over the functions of the Office of Registrar of Occupational Retirement Schemes in January 2000 to oversee the administration of the schemes governed by the Occupational Retirement Schemes Ordinance (ORSO) (Cap. 426).



## 45. Organizational structure

### Management Board

#### *Functions*

45.1 The Management Board (the Board) is responsible for governing the operations of MPFA. Its major functions are:

- (a) monitoring the implementation of the MPF system;
- (b) examining the effectiveness and efficiency of MPFA;
- (c) reviewing staff remuneration packages; and
- (d) monitoring internal financial controls.

#### *Membership of the Board*

45.2 Under MPFSO, the Chairman of the Board should be a Non-executive Director. At least one but no more than two of the Non-executive Directors should represent the interests of employees and the same number of Non-executive Directors should represent the interests of employers. Another requirement is that the majority of the Directors must be Non-executive Directors.

45.3 At present, there are ten Non-executive Directors and five Executive Directors on the Board, with the Non-executive Directors coming from the Administration, a bank, a labour union, an industrial company, an accounting firm, the Town Planning Appeal Board, the Equal Opportunities Commission and the Hong Kong Monetary Authority.

#### *Appointment*

45.4 Sections 6A to 6C of MPFSO stipulate that the Directors of the Board are appointed by the Chief Executive of the Hong Kong Special Administrative Region (CE of HKSAR).

45.5 The Board members are appointed for a term of no more than four years, but are eligible for reappointment.

- 45.6 Under MPFSO, a Board member may be removed from the office if he:
- (a) resigns from the office;
  - (b) becomes bankrupt;
  - (c) becomes of unsound mind or incapable of carrying out his duties;
  - (d) is convicted in Hong Kong of an offence which is punishable by imprisonment for 12 months or more, or is convicted of an offence of similar degree of severity elsewhere; or
  - (e) is removed from office by CE of HKSAR.

#### Mandatory Provident Fund Schemes Advisory Committee

45.7 MPFA is advised by the Mandatory Provident Fund Schemes Advisory Committee (MPFSAC) which is a statutory body established under MPFSO to make recommendations on issues relating to the implementation of the MPF system and the internal operation of MPFA.

45.8 Under MPFSO, MPFSAC consists of an Executive Director designated by MPFA and nine to 11 other members appointed by CE of HKSAR. There must be an equal representation of employers and employees. The Chairman and the Deputy Chairman of MPFSAC are appointed by CE of HKSAR from among its members.

#### Industry Schemes Committee

45.9 The Industry Schemes Committee (ISC), another statutory body established under MPFSO, is responsible for monitoring the effectiveness of industry schemes and advising on ways to improve the administration and operation of the schemes. ISC consists of a chairperson, at least one (but no more than two) representatives of the approved trustee of each industry scheme, an Executive Director designated by MPFA and no fewer than six other persons. There must also be an equal representation of employers and employees. Except for MPFA's Executive Director, the other members of ISC are appointed by the Financial Secretary (FS).

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### Senior management

45.10 The various functions of MPFA are performed by its six divisions<sup>48</sup> under the direction of the Managing Director, two Chief Operating Officers and two Executive Directors, who are members of the Management Board. (See Appendix VII for the organizational structure of MPFA.)

45.11 Under section 6B of MPFSO, one of the Executive Directors is appointed by CE of HKSAR as the Managing Director of MPFA, who is the administrative head of MPFA and is responsible for administering the affairs of MPFA. The Managing Director is, by virtue of holding that office, the Deputy Chairperson of MPFA.

## **46. Funding of the Mandatory Provident Fund Schemes Authority**

### Capital grant

46.1 A capital grant of HK\$5 billion for financing the establishment and operating costs of MPFA was approved by the Finance Committee (FC) of the Legislative Council (LegCo) in April 1998. After meeting the operating expenses of MPFA, the capital grant is deposited with banks and invested in debt securities and listed investments. MPFA is expected to operate on a self-financing basis in the longer term through fees and charges collected and investment returns generated from the capital grant. MPFA has not requested any additional funding support from the Administration since its inception in 1998.

### Sources of income

46.2 MPFA derives its income from the following sources:

- (a) *Fee Income* may be imposed by MPFA according to the MPF Schemes (Fees) Regulation (Fees Regulation). These fees include fees payable on application for approval of trustees and pooled investment funds, and registration of MPF schemes. Amendments to the Fees Regulation require the approval of LegCo. Fee income amounted to about HK\$11.7 million in Financial Year<sup>49</sup> 2001-02.
- (b) *Interest Income* amounted to HK\$111.5 million in Financial Year 2001-02.
- (c) *Net Investment Income* from securities totalled HK\$103.0 million in Financial Year 2001-02.

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<sup>48</sup> MPFA is organized into six divisions, namely Supervision Division, Enforcement Division, Investment Regulation Division, Policy and Development Division, Corporate Services Division and External Affairs Division.

<sup>49</sup> Financial year begins on 1 April and ends on 31 March of the following year.

## **47. Mechanism for approving and controlling expenditure**

### Budgetary process

47.1 The budget is drawn up by the management with reference to the MPFA's corporate plan. Under section 6J of MPFSO, the corporate plan must specify:

- (a) the objectives of MPFA's activities for the financial year concerned;
- (b) the nature and scope of activities to be undertaken in order to achieve these objectives; and
- (c) an estimated expenditure for achieving these objectives.

47.2 The proposed budget is first discussed by its Administration Committee and Finance Committee, and then endorsed by the Management Board. As part of MPFA's annual corporate plan, the budget must be submitted to FS for approval.

### Controlling of expenditure

47.3 The total expenditure of MPFA amounted to about HK\$244.4 million in Financial Year 2001-02. The major expenditure category was staff and related expenses, which amounted to HK\$161.0 million, or 65.9% of the total expenditure.

47.4 As regards capital expenditure, it follows the same approval procedure as that for operating expenditure. In Financial Year 2001-02, capital expenditure amounted to HK\$36 million.

47.5 Under MPFSO, MPFA must produce true and fair financial statements, which will be submitted to MPFA's auditor for auditing. In addition, MPFA must deliver a copy of audited financial statements and auditor's report on those statements to FS for acceptance.

## **48. Remuneration for Directors and staff**

### Remuneration for Directors

48.1 Under section 3 of schedule 1A of MPFSO, MPFA's Directors are entitled to such terms and conditions of office as CE of HKSAR may, from time to time, determine. However, according to MPFA, the Non-executive Directors of MPFA, including the Chairman, are not remunerated.

### Remuneration for staff

48.2 MPFA may employ staff to exercise or perform its functions.<sup>50</sup> The current establishment of MPFA is 292. MPFA may, after consultation with FS, determine the salaries and other conditions of employment of its staff.<sup>51</sup>

48.3 The current annual remuneration packages for the positions of the Managing Director, Chief Operating Officers and Executive Directors are around HK\$5 million, HK\$3 million and HK\$2.7 million respectively.

48.4 According to the report entitled *Review of Remuneration of Senior Executives in Statutory and Other Bodies* issued by the Hay Group Limited (Hay Report) in June 2002, the proposed remuneration levels<sup>52</sup> of the Managing Director, Chief Operating Officers and Executive Directors of MPFA are HK\$4.9 million, HK\$3.41 million, and HK\$2.35 million respectively. The Board, at its meeting held on 1 August 2002, accepted the recommendations in the Hay Report.

### Process in reviewing remuneration for Directors and staff

48.5 The remuneration package for MPFA's Directors (including its Managing Director and Executive Directors) and its staff consists of a fixed basic salary and a variable pay which is a discretionary performance-linked variable pay. The Board decides on the salary adjustment and the percentage of the variable pay to be granted to the MPFA staff each year.

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<sup>50</sup> Section 6G(1) of MPFSO.

<sup>51</sup> Section 6G(2) of MPFSO.

<sup>52</sup> The comparison group comprises banks, trustees, asset management firms and professional services companies.

## 49. Accountability arrangements

49.1 MPFSO and ORSO require that MPFA reports its operations to FS. The major accountability arrangements between MPFA and the Administration are:

- (a) the appointment of the Chairman, Managing Director and Directors requires the approval of CE of HKSAR;
- (b) both the corporate plan and budget require the approval of FS; and
- (c) MPFA must submit reports on its activities and the implementation of the MPF legislation, the annual report, as well as the audited financial statements and the auditor's report on these statements to FS for acceptance.

49.2 MPFA is accountable to LegCo through a number of channels:

- (a) answering questions raised by LegCo Members at Council meetings<sup>53</sup>;
- (b) briefing relevant Panels and Bills Committees;
- (c) seeking the approval of public funding; and
- (d) submitting monthly progress reports on the implementation of MPF system to LegCo Manpower Panel.

49.3 MPFA keeps the public informed about the MPF system and its work by publishing a variety of documents, including MPFA annual reports, guidebooks on the MPF system, booklets<sup>54</sup>, guidelines<sup>55</sup>, codes<sup>56</sup> and statistical digests<sup>57</sup>. These documents are also available on MPFA's website.

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<sup>53</sup> During the second term of LegCo, there were 15 LegCo questions on the MPF system.

<sup>54</sup> Topics of booklets include main features of the MPF system, relevant income and choosing MPF investment funds.

<sup>55</sup> There are guidelines on licensing, reporting requirements, investment, scheme operations and ORSO interface.

<sup>56</sup> They include Codes on MPF investment funds and MPF intermediaries.

<sup>57</sup> The Digest contains key statistical information, such as enrolment rates, the consolidated net asset values of the MPF schemes, and similar data on the ORSO schemes.

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49.4 In addition, MPFA conducts publicity campaigns<sup>58</sup> and public education programmes to promote the awareness of the MPF system and to educate the public on their MPF rights.

## **50. Impact of the accountability system for Principal Officials**

### Operational independence

50.1 There is no specific legislation on MPFA's operational independence.

### Impact of the accountability system

50.2 The Administration implemented a new accountability system for its Principal Officials in July 2002. In this respect, MPFA has replied that the mandate, powers and functions of MPFA are set out in MPFSO and ORSO. MPFA will continue to discharge the duties in accordance with the legislation. MPFA does not foresee any major impact of the accountability system on its governance.

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<sup>58</sup> Major campaigns include: MPF Awareness Campaign, Celebrities Endorsement Campaign, Industry Scheme Campaign and Operation-All-Shops (i.e. a programme of MPFA ambassadors visiting over 50 000 shops to promote the MPF system.)

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## **Part 8 - The Bank of England, the United Kingdom**

### **51. Powers and functions of the Bank of England**

51.1 Established in 1694 by an Act of Parliament and the Royal Charter as a corporate body, the Bank of England (the Bank) is the central bank of the United Kingdom (UK). Its capital stock was acquired by the UK government in 1946. Fundamental changes to the Bank's role took effect under the Bank of England Act 1998 (the Act), including the acquisition of operational responsibility for setting interest rates.

51.2 The major functions of the Bank are:

- (a) maintaining the overall stability of the financial system<sup>59</sup>;
- (b) setting interest rates to maintain price stability, stabilizing the exchange rate and sustaining the government's economic policy;
- (c) monitoring developments in the financial system;
- (d) promoting the effectiveness of the financial services sector;
- (e) administering the payment and settlement systems; and
- (f) issuing banknotes.

### **52. Organizational structure**

#### The Court of Directors

52.1 The Act provides for the appointment by HM Treasury of the Governor, two Deputy Governors and 16 Non-executive Directors who collectively make up the management board of the Bank, known as the Court of Directors (the Court). In addition, a committee consisting of the 16 Non-executive Directors is established under the Court and is known as the Non-executive Committee (NedCo).

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<sup>59</sup> Following the enactment of the Act, the responsibility for the supervision of banks and deposit-taking institutions was transferred to the Financial Services Authority (FSA).



### *Functions*

52.2 The Act provides that the Court manages the Bank's affairs other than the formulation of monetary policy, which is the responsibility of the Monetary Policy Committee (MPC)<sup>60</sup>. The Court's major functions are:

- (a) determining the Bank's objectives and strategies; and
- (b) ensuring the effective discharge of the Bank's functions and the efficient use of the Bank's resources.

52.3 The Act also provides that NedCo should carry out the following statutory functions:

- (a) reviewing the Bank's performance in relation to its objectives and strategies for the respective financial year<sup>61</sup>;
- (b) reviewing the procedures followed by MPC;
- (c) reviewing the internal financial controls of the Bank;
- (d) determining the remuneration and pensions of the Governor and Deputy Governors; and
- (e) determining the terms and conditions of services of MPC members appointed by HM Treasury.

### *Membership of the Court*

52.4 The 16 Non-executive Directors serve in their personal capacity and act in the best interest of the UK economy. They, however, do not represent any particular interests or organizations. They therefore come from different fields and organizations, including industry regulators,<sup>62</sup> commerce, finance, consumers' associations, workers' unions, regional development agencies and cultural programme organizers.

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<sup>60</sup> The Act provides for the establishment of MPC as a Committee of the Bank, which is subject to the oversight of NedCo. MPC consists of the Governor and Deputy Governors of the Bank, two members appointed by the Governor, and four members appointed by HM Treasury. The Act stipulates that MPC must meet (at least) monthly to review and if necessary change interest rates so as to deliver price stability and to sustain the Administration's economic policy. Decisions on interest rates are announced after each meeting. The minutes of the meetings are available to the public.

<sup>61</sup> Financial year begins on 1 March and ends on 28 February of the following year.

<sup>62</sup> The Chairman of FSA is a member of the Court.

### *Appointment*

52.5 The Court is publicly recruited and the appointment should follow the Seven Principles of Public Life (also known as the Nolan Principles) which govern the standards of conduct for all holders of public office. All public bodies in the UK are required to draw up their own codes of conduct incorporating the Seven Principles and to introduce internal systems for maintaining the standards. (See Appendix VIII for the Seven Principles.)

52.6 The Governor and Deputy Governors are appointed for five-year terms and the Non-executive Directors for three-year terms<sup>63</sup>. They are subject to reappointment.

52.7 The Bank can, with the consent of HM Treasury, remove members of the Court if it is satisfied that:

- (a) the member has been absent from meetings of the Court for more than three months without the consent of the Court;
- (b) the member has become bankrupt; or
- (c) the member is unable or unfit to discharge his functions.

### *Court meetings*

52.8 The Act stipulates that the Court meets at least once a month and that the Bank reports on its activities annually to HM Treasury.

### Management structure

52.9 Under the Court, the Bank's senior policy-making body is the Governor's Committee, comprising the Governor, two Deputy Governors and three Executive Directors, engaged directly by the Bank. The internal management of the Bank is the responsibility of the Management Committee, comprising the Deputy Governor (Financial Stability), four Deputy Directors (Market Operations, Monetary Analysis and Statistics, Financial Stability, and Banking and Market Services), the Finance Director and the Director of Personnel. The management structure of the Bank is based on three main operational areas, i.e. Monetary Analysis and Statistics, Financial Market Operations and Financial Stability. (See Appendix IX for the organizational structure of the Bank.)

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<sup>63</sup> Depending on reappointments, vacancies may arise by rotation each year in June.

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### **53. Funding of the Bank of England**

53.1 The Bank's activities are funded by its own capital and reserves, which amounted to £1.53 billion, and cash ratio deposits (i.e. non-interest bearing deposits from banks and building societies) of £1.55 billion on 28 February 2002. Under the current arrangement, the Bank is authorized to retain a sum equal to 50% of post-tax profit and pay the remaining 50% to HM Treasury. In Financial Year 2001-02, the Bank recorded a post-tax profit of £84 million<sup>64</sup>; hence, the Bank retained £42 million and paid HM Treasury a sum of £42 million.

### **54. Mechanism for approving and controlling expenditure**

#### Budgetary process

54.1 The Court is responsible for determining the Bank's objectives and strategies, which provide the basis for the allocation of budgetary resources. The process for the budget review and approval by the Court in each financial year involves the Finance Director compiling a document with the following two sections:

- (a) Consolidation position — which includes a commentary on the budget, a set of tables providing Bank-wide information and charts showing headcount and long-run trends in Bank costs and staff numbers; and
- (b) Business units — which includes budgeted costs and income for each unit.

#### Controlling of expenditure

54.2 The same approval mechanism is adopted for operating and capital expenditures.

54.3 The Bank's total expenditure for Financial Year 2001-02 was £207.7 million. The aggregate remuneration for the corresponding period amounted to £80 million, or 38.5% of the total expenditure. The Court has agreed to increase the expenditure budget to £220.5 million for Financial Year 2002-03, providing resources for fulfilling the determined objectives. Since the Bank has an abundant capital and reserves to finance its operations, it does not need to request any funding support from the UK government.

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<sup>64</sup> The agreement between HM Treasury and the Bank provides that the entire profit of notes issued is paid over to HM Treasury. For accounting purposes, such profit will not be included in the Bank's financial statements.

54.4 The Act requires that the Bank should keep proper accounts and records, and should appoint an external auditor to audit its accounts. The Bank is also required to send a copy of the auditor's opinion on the financial statements and statements of account to HM Treasury.

54.5 In addition, the Audit Committee<sup>65</sup>, a committee under the Court, is established to fulfil the following functions:

- (a) keeping under review the internal financial controls<sup>66</sup> of the Bank;
- (b) receiving reports from both internal and external auditors; and
- (c) reviewing the annual financial statements prior to their submission to the Court, including consideration of the appropriateness of the accounting policies and procedures adopted, and reporting its conclusions to the Court.

## **55. Remuneration for Governors, Directors and staff**

### Approving authorities

55.1 While the appointment of the Governors, the Executive Directors and the members of MPC is made by HM Treasury, their remuneration is determined by the Court. The remuneration of Non-executive Directors is determined by the Court with the approval of HM Treasury.

55.2 The Bank is empowered to employ staff to carry out its functions. In Financial Year 2001-02, the number of staff was about 2 250. The Court is advised by the Remuneration Committee established under NedCo. The Committee consists of a chairman and three members. During Financial Year 2001-02, members of the Remuneration Committee came from the fields of commerce, workers' union, regional development agency and cultural programme organizer. There is no executive member of the Court sitting on the Remuneration Committee. In addition, the executive members are not involved in the deliberation on their remuneration.

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<sup>65</sup> The Audit Committee consists of a chairman and four members, all of whom are Non-executive Directors.

<sup>66</sup> The Internal Audit Division provides independent risk assurance to senior management, reviews the adequacy of the Bank's internal system and tests compliance with agreed procedures for managing risks.

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### Remuneration structure for Governors

55.3 The remuneration arrangements for the Governor and Deputy Governors consist of the following components:

- (a) Base salaries — during Financial Year 2001-02, the salaries of the Governor and Deputy Governors were £250,567 and £202,500 respectively. The Remuneration Committee is committed to adjusting their salaries in line with the annual inflation rate.
- (b) Benefits — the Remuneration Committee keeps under review benefits available to the Governors. Medical insurance and pension are the principal benefits. During Financial Year 2001-02, the amounts of benefits payable to the Governor and Deputy Governors were £1,379 and £315 - £966 respectively.
- (c) Post-retirement benefits — post-retirement benefits are generally provided through the Court Pension Scheme<sup>67</sup>.

55.4 The Bank's annual report contains detailed information on the general remuneration policies, remuneration structure for the Governors, and remuneration of NedCo and MPC members. The Companies Act does not require the disclosure of the salaries of the Executive Directors who are not members of the Court.

### Remuneration of Non-executive Directors

55.5 The remuneration of Non-executive Directors is £5,000 per annum and the remuneration of the Chairman of NedCo is £7,500 per annum. Non-executive Directors do not receive any post-retirement benefits from the Bank.

### Remuneration for staff

55.6 The Remuneration Committee's approach is to review salaries of the Bank's staff annually, aiming to set remuneration and conditions of service to reflect staff qualifications, experience, responsibilities and performance.

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<sup>67</sup> It is a non-contributory scheme. The normal retirement age is 60, which allows members of the scheme to have a maximum pension of two-thirds of their pensionable salary at normal retirement age after 20 years of service.

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55.7 In addition to determining salary levels, the Remuneration Committee may recommend the payment of bonuses as a means of rewarding special services or individual performance. In proposing salary and bonuses, the Committee makes both internal and external salary comparisons. Where appropriate, it commissions external professional advice on the levels of pay and benefits in both comparable public institutions and the private sector. With regard to advising the Court on remuneration at senior levels within the Bank, the Committee also considers the Bank's position within the public sector.

55.8 The Remuneration Committee's responsibility relates to senior executives only, while decisions on remuneration for the generality of staff are made by Heads of Division. An across-the-board salary award is paid to banking staff whose performance is deemed satisfactory and the amount of this award is determined by the Bank following negotiations with the staff union.

## **56. Accountability arrangements**

56.1 The Bank is accountable to HM Treasury. In particular, the Act requires that the Court reports annually to HM Treasury regarding its activities, which include the following:

- (a) a report by the Directors of the Bank on the matters for which the Committees (e.g. the Remuneration Committee and the Audit Committee) established are responsible;
- (b) a statement of accounts for the financial year and the report of the Bank's auditors;
- (c) a statement of the Bank's objectives and strategies and the review of the Bank's performance in relation to the determined objectives and strategies in the preceding financial year; and
- (d) a statement of the rate or rates at which the Directors of the Bank have been remunerated in the financial year concerned.

56.2 The Bank is accountable to Parliament through a variety of channels:

- (a) under the Act, HM Treasury should lay the Bank's annual report before Parliament and this will be a subject of annual debate in the House of Commons (the House);
- (b) the Governors and Bank officials may need to explain their decisions to the Treasury Committee of the House and to provide the required information to the Treasury Committee; and
- (c) members of the Court (including the Governors) may be invited to appear before the Treasury Committee of the House to comment on the discharge of their responsibilities.

56.3 The Bank emphasizes that transparency is an important element to ensure proper accountability. It provides the public with detailed information on the following:

- (a) the roles of the Court of Directors and its Committees, and the names of members of the Court, together with the principal outside appointments of Non-executive Directors;
- (b) the Bank's objectives and the review of the Bank's performance against the determined objectives in the preceding financial year;
- (c) minutes of MPC meetings; and
- (d) the general remuneration policies and remuneration structure for the Governors, and remuneration of NedCo and MPC members.

## **57. Operational independence**

57.1 The Bank's operational independence in setting interest rates is included in the Act. The Act also provides for HM Treasury, after consultation with the Governor of the Bank, the powers to determine interest rates in respect of "public interest" and "extreme economic circumstances". Both terms are not defined in the Act and are subject to HM Treasury's interpretation.

## **Part 9 - Financial Services Authority, the United Kingdom**

### **58. Powers and functions of the Financial Services Authority**

58.1 The Financial Services and Markets Act (FSMA) provides for the establishment of the Financial Services Authority (FSA) in June 2000. FSA is the single regulator of financial services in the United Kingdom (UK) and is an independent non-governmental body. It has taken over from the nine regulatory bodies in the regulation of banks, building societies, insurance companies, friendly societies, credit unions, Lloyd's<sup>68</sup>, investment and pensions advisers, stockbrokers, professional firms offering investment services, fund managers and derivatives traders.

58.2 FSMA requires FSA to establish the Financial Ombudsman Service for the resolution of disputes between authorized firms and their customers, and to create the Financial Services Compensation Scheme for the payment of compensation to consumers who suffer financial loss as a consequence of the inability of authorized firms to meet their liabilities.

58.3 Sections 3 - 6 of FSMA stipulate the four statutory objectives of FSA:

- (a) maintaining confidence in the financial system;
- (b) promoting public understanding of the financial system;
- (c) securing an appropriate degree of protection for consumers; and
- (d) reducing financial crime.

58.4 In accordance with the above objectives, FSA exercises the following functions:

- (a) admitting firms to the regulatory system through an authorization or approval process;
- (b) setting business standards for firms;
- (c) supervising firms or individuals in delivering their standards;
- (d) taking action against firms where problems arise; and
- (e) resolving complaints against firms and paying compensation if firms collapse.

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<sup>68</sup> Lloyd's is an insurance market rather than an insurance company. It is a brokered market and focuses on high risk, specialist insurance for businesses.

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## 59. Organizational structure

### The Board of Directors

59.1 FSMA provides for the appointment by HM Treasury of the Board of Directors (the Board) as the governing body of FSA. The Board consists of an Executive Chairman<sup>69</sup>, three Managing Directors, one Chief Operating Officer and 11 Non-executive Directors (one of whom is the Deputy Chairman). FSMA also stipulates that the majority of the Board members are Non-executive members.

59.2 According to FSA, the combined role of the Chairman and the Chief Executive is the best structure for meeting FSA's objectives, better communication between the Board and senior management, and speedy decision-making. In Financial Year<sup>70</sup> 2001-02, the Non-executive Committee (known as NedCo) of the Board, comprising all of the 11 Non-executive Directors, reviewed the effectiveness of the Board in monitoring the activities of FSA. After the review, they were satisfied that the present arrangement should continue.

### *Functions*

59.3 The Board is responsible for governing FSA's affairs. In practice, NedCo is the body to carry out statutory functions, which are:

- (a) keeping under review whether FSA is using its resources efficiently and economically;
- (b) keeping under review whether FSA's internal financial controls secure the proper conduct of its financial affairs;
- (c) determining the remuneration of the Chairman and other executive members of the Board; and
- (d) reporting on these matters as part of FSA's annual report to HM Treasury.

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<sup>69</sup> The current Chairman of FSA is also the Chief Executive. HM Treasury appointed Sir Howard Davies to this role in 1997.

<sup>70</sup> Financial year begins on 1 April and ends on 31 March of the following year.

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### *Membership of the Board of Directors*

59.4 Board members are appointed by HM Treasury. Members of the Board, including the Executive Chairman, are publicly recruited and the appointment should follow the Seven Principles of Public Life (i.e. the Nolan Principles) which govern the standards of conduct for all holders of public office. All public bodies in the UK are required to draw up their own codes of conduct incorporating the Seven Principles and to introduce internal systems for maintaining the standards. (See Appendix VIII for the Seven Principles.)

59.5 As in the case of the Bank of England, the Non-executive Directors of FSA serve in their personal capacity and do not represent any particular interests or various organizations. They act in the best interest of the UK economy. They come from different organizations, such as the Bank of England<sup>71</sup>, banks, finance companies, venture capital companies, consumer councils, consumer protection groups, industrial associations, legal firms and universities.

59.6 Board members are appointed for three-year terms and are subject to reappointment. There are no statutory rules governing the removal of the board members.

### *Board meetings*

59.7 According to FSA, the Board meets at least 11 times a year.

### Management structure

59.8 Day-to-day operational decisions and management of the staff are the responsibilities of the executive management of FSA. The Chairman is responsible for the overall strategic direction and management of FSA. Three Managing Directors and a Chief Operating Officer report to the Chairman. Three supervisory divisions, Consumer, Investment and Insurance Division, Deposit Takers and Markets Division and Regulatory Processes and Risk Division, are established to regulate various types of financial institutions. (See Appendix X for the organizational structure of FSA.)

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<sup>71</sup> The Deputy Governor (Financial Stability) of the Bank of England is an ex officio director.

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## **60. Funding of the Financial Services Authority**

60.1 FSA is an independent non-governmental body financed by levies on financial firms it regulates. It is empowered to determine the fees charged<sup>72</sup> and receives no funding support from the UK government. In Financial Year 2001-02, FSA raised £120.2 million in fees from regulated firms and £73.1 million for services provided. FSA recorded a deficit of £6.1 million for the respective period because of the internal reorganization that took place in April 2001. The result was a decrease in reserves from £9.5 million to £3.3 million. FSA is committed to raising the reserve level to £5.5 million in Financial Year 2002-03.

## **61. Mechanism for approving and controlling expenditure**

### Budgetary process

61.1 FSA has to observe the four statutory objectives and the Principles of Good Regulation<sup>73</sup> in discharging its functions, which provide the basis for the allocation of budgetary resources.

61.2 The budget is reviewed and approved by the Board. It is subject to extensive public consultation, in particular with recognized bodies, authorized firms and their trade associations. FSA's Plan and Budget are available to the public.

### Controlling of expenditure

61.3 The same approval mechanism is adopted for operating and capital expenditures.

61.4 FSA's total expenditure in Financial Year 2001-02 was £199.1 million. Staff costs<sup>74</sup> amounted to £113.5 million, accounting for 57.0% of the total expenditure. The cost of leasing office premises amounted to £8.34 million in Financial Year 2001 - 02.<sup>75</sup> In Financial Year 2001-02, capital expenditure amounted to £6.5 million.

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<sup>72</sup> FSA has issued a series of consultation papers that contain details about its fees arrangements and how they are calculated.

<sup>73</sup> The Principles of Good Regulation include: (a) using resources in the most economic and efficient way; (b) being proportionate in imposing burdens or restrictions on the industry; (c) facilitating innovation; (d) considering the international character of financial services and the UK's competitiveness; and (e) avoiding unnecessarily distorting or impeding competition.

<sup>74</sup> These include salaries, pensions, and costs of travel, training and recruitment.

<sup>75</sup> The information was provided in FSA's annual report.

61.5 FSMA requires that FSA should keep proper accounts and records, and appoint an external auditor to audit its accounts. FSA is required to submit a copy of the auditor's report to HM Treasury.

61.6 In addition, the Audit Committee<sup>76</sup> established under the Board is responsible for reviewing the financial accounts and their underlying accounting policies and principles, monitoring the internal audit functions and keeping under review the system of internal financial and other controls. The Audit Committee reports these matters to the Board, which is entrusted with the responsibility of monitoring FSA's system of internal control and reviewing its effectiveness.

## **62. Remuneration arrangements**

### Remuneration for the Board

62.1 HM Treasury is responsible for determining the Non-executive Directors' emoluments, and is advised by an independent panel comprising the Chairs of the Financial Services Consumer Panel and the Financial Services Practitioner Panel and an external moderator. The emoluments of the Deputy Chairman and Non-executive Directors for Financial Year 2001-02 were £37,667 and £16,000 - £21,000 respectively.

62.2 The Remuneration Committee<sup>77</sup>, on behalf of NedCo, determines the appropriate general policies on executive remuneration and specific levels of remuneration for the Executive Chairman and Managing Directors. The Remuneration Committee had a chairman and three members, who came from a legal firm, a bank, a venture capital company and the consumer council respectively in Financial Year 2001-02. The Committee met twice in Financial Year 2001-02. The Chairman of FSA is not a member of the Remuneration Committee but is normally invited to attend all remuneration discussions, except when matters concerning his own position are being considered.

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<sup>76</sup> Membership of the Audit Committee comprises only Non-executive Directors. The Committee consists of a chairman and four members. They come from the fields of legal service, banks and industrial associations.

<sup>77</sup> It is a committee established under NedCo.

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62.3 The remuneration packages for the Chairman and Managing Directors, as well as for other employees of FSA, consist of four elements:

- (a) Basic salary — the basic salaries of the Chairman and Managing Directors were reviewed during Financial Year 2001-02, in accordance with the criteria set out in paragraph 62.7 below. The Chairman's basic salary was set at the rate of £315,000 and the Managing Directors' basic salaries were in the range of £187,500 - £254,900.
- (b) Performance-related bonus — a performance-related bonus plan is in place for the employees of FSA. The performance criteria are the achievement of specified objectives, personal performance during the year and the impact of their work on the reputation and standing of FSA. These criteria are assessed following the advice from the Chairs of the Financial Services Consumer Panel and the Financial Services Practitioner Panel<sup>78</sup> and HM Treasury. The bonuses awarded by the Committee in respect of Financial Year 2001-02 were: £37,800 for the Chairman and £25,000 - £30,000 for Managing Directors.
- (c) Benefits — a flexible benefits plan is in operation for all employees, and the Chairman and Managing Directors participate in this plan. In Financial Year 2001-02, the amounts of benefits payable to the Chairman and Managing Directors were £26,940 and £15,706 - £21,538 respectively.
- (d) Pensions — the Chairman and Managing Directors are members of the non-contributory pension plan.

62.4 FSA's annual report contains detailed information on the general remuneration policies, remuneration structure and remuneration packages for the Chairman and Managing Directors, and remuneration of NedCo members.

#### Remuneration for staff

62.5 FSA can employ staff to carry out its duties. In March 2002, the number of staff was about 2 300.

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<sup>78</sup> See paragraph 63.2 for a discussion of the two Panels.

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62.6 The Remuneration Committee monitors FSA's remuneration policies and reports to NedCo that the arrangements are competitive, motivating for those concerned, and in the best interests of FSA.

62.7 When reviewing staff remuneration packages, the Remuneration Committee takes into account the remuneration package of comparable positions in the financial services market and in other institutions with a regulatory or public role, as well as the impact of market forces on levels of remuneration in these sectors during the year.

### **63. Accountability arrangements**

63.1 FSA is accountable to HM Treasury through the following channels:

- (a) FSA is governed by the Board whose members are appointed by HM Treasury;
- (b) FSA is required to report annually to HM Treasury on the fulfilment of its statutory objectives;
- (c) In exercising its rule-making powers and setting its policies, FSA must observe the statutory objectives and the Principles of Good Regulation; and
- (d) NedCo is required to submit to HM Treasury a separate report on discharging its statutory functions, reviewing the efficiency and economy of the operation of FSA and overseeing its system of financial control.

63.2 To enhance FSA's accountability to the public and to Parliament, the following arrangements have been put in place:

- (a) FSA's report to HM Treasury on the fulfilment of the statutory objectives is laid before Parliament;
- (b) FSA is required to brief the Treasury Select Committee of the House of Commons (the House);
- (c) The Treasury Select Committee of the House is empowered to commission independent investigations to inquire into any regulatory matters of FSA which are of public concerns;
- (d) FSMA requires that an independent tribunal should be set up for reviewing FSA's regulatory decisions. The Financial Services and Market Tribunal, run by the Chancellor's Department, considers certain regulatory decisions afresh when there is no agreement on the outcome between FSA and the firm or individual concerned;
- (e) FSA has a duty to consult consumers and the financial industry on its policies, rules, fees, complaints handling arrangements and other related matters. Under FSMA, FSA has the statutory obligation to establish the Financial Services Consumer Panel that advises FSA on its policies, monitors the effectiveness of its work and reviews developments in financial services with an impact on consumers. The Panel also establishes the Financial Services Practitioner Panel that provides the industry's views on any new or revised policies or rules of FSA which may have a material impact on regulated firms;
- (f) FSA is required to hold an open meeting to present its annual report. Representatives of consumers and of the regulated industry are invited to attend the annual public meeting;
- (g) FSA's rules and practices are subject to competition scrutiny by the Director General of Fair Trading. He must report to the Competition Commission if he finds that any of them has a significant anti-competition effect;
- (h) FSA has set up arrangements, as required by FSMA, for investigating complaints made against FSA. Complaints may be made by anyone directly affected by FSA's actions or inaction. As part of these arrangements, FSA has appointed a Complaints Commissioner. The Commissioner's role is to investigate complaints and report to both the complainant and FSA. The report may include recommendations to FSA, for example, that FSA should make a compensatory payment to the complainant. The Board will then decide whether to make such a payment. FSA's Complaints Commissioner publishes an annual report on his work; and
- (i) FSA publishes a wide range of materials for different audiences, including annual report, annual plan and annual budget. Details are available on its website.

## **64. Operational independence**

64.1 According to HM Treasury, it is important for FSA to function as an independent industry regulator of financial services in order to maintain confidence in financial services for businesses and consumers. Hence, the UK government is committed to maintaining FSA's operational independence. FSA also states that clear statutory objectives are vital to the long-term credibility of FSA, both domestically and internationally.



## **Part 10 - The Federal Reserve System, the United States of America**

### **65. Powers and functions of the Federal Reserve System**

65.1 The Federal Reserve System (Fed), established by the Federal Reserve Act of 1913 (the Act), is the central bank of the United States of America (US). Before the Fed came into place, the US had experienced many bank failures, business bankruptcies and severe economic downturns amid periodic financial panics. The establishment of the Fed at the time was to create a central bank that could prevent financial disruptions and bring about a safer and more flexible monetary and financial system.

65.2 The Fed's duties fall into four general areas:

- (a) formulating the monetary policy;
- (b) supervising and regulating banking institutions and protecting the credit rights of consumers;
- (c) maintaining the stability of the financial system and containing systemic risk that may arise in financial markets; and
- (d) providing financial services to the US government, the public, financial institutions, and foreign official institutions.

### **66. Organizational structure**

66.1 The current structure of the Fed has three major components, namely the Board of Governors (the Board), 12 regional Federal Reserve Banks (FRBs) and 3 000-plus member banks.

#### Board of Governors

66.2 The Board has been established as a federal government agency since its inception. It serves as the management board of the Fed.

### *Functions*

66.3 The major statutory functions of the Board are:

- (a) overseeing the implementation of the Fed's policies and directives;
- (b) formulating the monetary policy;
- (c) supervising the operations of FRBs; and
- (d) regulating the banking industry.

66.4 In formulating the monetary policy, all Board members sit on the Federal Open Market Committee (FOMC). FOMC usually meets eight times a year and directs open market operations<sup>79</sup>, the principal means which the Fed employs to implement its monetary policy. Apart from the Board members, FOMC also consists of the president of the FRB of New York, and presidents of four other FRBs who serve on a rotating basis.

### *Membership of the Board of Governors*

66.5 When selecting a Board member, the US President is required under the Act to give due regard to a fair representation of financial, agricultural, industrial and commercial interests, as well as geographical divisions of the country. No more than one Board member can be selected from any one Federal Reserve District<sup>80</sup>.

### *Appointment of the Board members*

66.6 The Board is made up of seven members appointed by the US President, with the advice and consent of the Senate. The Chairman and the Vice Chairman of the Board are chosen by the US President, upon the consent of the Senate, from among the seven Board members.

66.7 The full term for a Board member is 14 years, and the terms are arranged so that one term expires every two years. After serving a full term, a Board member cannot be re-appointed. If a Board member leaves the Fed before his term expires, the successor so appointed and confirmed to serve the remainder of the term may later be re-appointed to serve a full term.

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<sup>79</sup> Open market operations involve the sales and purchases of government securities to affect both the interest rates and the growth of money and credit.

<sup>80</sup> For the purpose of carrying out day-to-day operations of the Fed, the country has been divided into 12 Federal Reserve Districts with a FRB in each of these Districts.

66.8 The Chairman and the Vice Chairman are appointed for a term of four years, and could be re-appointed by the US President for additional terms within the constraints of their 14-year term as a Board member.

66.9 Under the Act, a Board member can only be removed by the US President for "causes", such as fraud and other personal misconduct.

#### *Board meetings*

66.10 The Board meeting is usually held twice a week.

#### Federal Reserve Banks

66.11 Another major component of the Fed is the 12 regional FRBs which serve as the operating arm of the Fed. These FRBs are located in major cities throughout the US. They perform a number of functions including operating a nation-wide payment system, rendering banking services to depository financial institutions<sup>81</sup>, and providing fiscal agency and depository services to the federal government<sup>82</sup>. They also carry out supervision and examination of commercial banks which are members of the Fed (known as member banks).

66.12 Each FRB consists of a board of nine directors. Member banks elect six members to the board, consisting of three bankers and three people from non-banking sectors. The Board appoints the remaining three directors who are selected with due considerations to the interests of industry, labour, agriculture, services, commerce and consumers.

#### Member banks

66.13 The Act requires all national banks, which are chartered by the Office of the Comptroller of the Currency, to be members of the Fed. State chartered banks are not required to join the Fed, but they can elect to become member banks if they meet the requirements set by the Board. (See Appendix XI for the organizational structure of the Fed.)

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<sup>81</sup> For example, FRBs provide cheque clearing and electronic fund transfer services to the depository financial institutions. In addition, financial institutions could borrow from FRBs through the discount window.

<sup>82</sup> As fiscal agents, FRBs issue, transfer, exchange and redeem government securities and savings bonds. As depositories, they provide transaction accounts for the Department of the Treasury, and collect and disburse funds on behalf of the federal government.

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## **67. Funding of the Federal Reserve System**

67.1 The funding of the Fed is derived primarily from the interest income on FRBs' holding of US government securities acquired through open market operations. For Financial Year<sup>83</sup> 2001, interest revenue from US government securities accounted for US\$30.5 billion or 95.8% of the Fed's total revenue.

67.2 Another source of revenue comes from the fees FRBs charge on depository financial institutions for providing services such as check clearing, fund transfers and automated clearinghouse operations. In addition, the Fed also receives interest income from investment in foreign currency assets and from loans to depository financial institutions.

67.3 The Fed deducts its expenses from the total revenue, and transfers the remaining amount to the Department of the Treasury (the Treasury) on an annual basis. The return of the net revenue to the Treasury is in accordance with a policy established by the Board, and is not required by federal statute. For Financial Year 2001, the Fed transferred about US\$27.1 billion or 85.1% of its total revenue to the Treasury.

## **68. Mechanism for approving and controlling expenditure**

### Budgetary process

68.1 On a biennial basis, the Board sets out a strategic plan for the next four years and a budget for the next two years. Meanwhile, the preliminary budget of each FRB will require the Board's approval.

68.2 As for capital expenditure, it follows the same approval procedure as that for operating expenditure.

### Controlling of expenditure

68.3 The Fed's total operating expenditure amounted to US\$2.7 billion in Financial Year 2001, of which FRBs and the Board accounted for US\$2.5 billion and US\$219.3 million respectively. The largest cost item for FRBs was personnel expense which accounted for US\$1.6 billion, or 63.7% of the total operating expenditure in the year. The same holds for the Board, and the corresponding figures were US\$158.4 million and 72.2%.

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<sup>83</sup> Financial year begins on 1 January and ends on 31 December of the same year.

68.4 Fed does not publish any breakdown for capital expenditure in its annual report. As of the date of publication of this report, the Fed has not provided us any figures for its capital expenditure.

68.5 The Board is audited annually by an independent public accounting firm, and the audit result is published in its annual report.

68.6 The Board contracts with an external audit firm for the annual audit of the combined financial statements of FRBs and the financial statements of each of the 12 FRBs. FRBs are also audited by their own internal audit department and by the Board's Division of Reserve Bank Operations and Payment Systems.

## **69. Remuneration for the Board and staff**

### Remuneration for the Board

69.1 The Chairman, the Vice Chairman and other Board members are remunerated under the Executive Schedule, the adjustment of which is subject to Congress's approval. There are three ways in which Congress can adjust the salaries on the Executive Schedule. Congress can pass special legislation authorizing pay increases. Alternatively, it can base the salary adjustments on the recommendations made by the Citizens' Commission on Public Service and Compensation (the Commission), or on the automatic mechanism set out in the provisions of the Ethics Reform Act of 1989.

### *Recommendations by Citizens' Commission on Public Service and Compensation*

69.2 In principle, the Commission convenes every fourth fiscal year to conduct a review on the Executive Schedule pay<sup>84</sup>. Leaders of the executive, legislative and judicial branches each appoint two members to the 11-member Commission. The remaining five members are drawn from the voter registration lists by the Administrator of General Services, with the consideration of achieving a maximum degree of geographic diversity among members.

69.3 The Commission reports the results of the review and its recommendations to the US President. After considering the Commission's report, the President will transmit to Congress his recommendations of the exact salaries for approval.

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<sup>84</sup> The Commission also reviews the salary of the Vice President, members of Congress and judges.

*Automatic mechanism*

69.4 According to the Ethics Reform Act of 1989, salary adjustments for positions remunerated under the Executive Schedule are based on the percentage change in the private sector wages and salaries as measured by the US Bureau of Labour Statistics' Employment Cost Index. Nonetheless, the salary adjustments for the Executive Schedule cannot exceed the rate adjustments for staff under the General Standard<sup>85</sup>.

69.5 Congress may choose not to follow the three ways mentioned above for salary adjustments. For example, in 1998, employees remunerated under the General Schedule received a 3.1% pay rise, whereas those covered by the Executive Schedule got no salary increase at all.

69.6 At present, the salary of the Chairman is set at Executive Schedule Level I<sup>86</sup>, which is US\$166,700. Salaries of the Vice Chairman and other Board members are set at Executive Schedule Level II, which is US\$150,000. Board members are also entitled to benefits such as health insurance, life insurance, thrift plan and retirement benefit.

Remuneration for staff

69.7 The Fed currently employs a total staff of about 25 000 people. Of this total, 1 500 people work for the Board and 23 500 for FRBs.

69.8 The annual salary adjustments of the Fed's staff are determined by the Board, which considers, among other things, whether the remuneration packages are competitive with those in the private and public sectors. As such, the Board conducts an annual salary survey of related job positions in the private and public institutions.

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<sup>85</sup> The basic pay for most federal rank-and-file, white-collar employees is stipulated under the General Schedule or "GS" system, which ranges from the lowest grade, GS-1, to the highest, GS-15. The basic pay of executives is covered by two other pay systems: the Executive Schedule and the pay system of the Senior Executive Service.

<sup>86</sup> The Executive Schedule is divided into five pay levels, the lowest of which is Level V.

## **70. Accountability arrangements**

70.1 The Fed is accountable to the Administration through a variety of channels:

- (a) the Fed is required under the Government Performance and Results Act of 1993 to develop a strategic plan, which outlines its mission, goals and objectives, and actual results in such a way as to be measurable;
- (b) the terms for both the chairmanship and the vice chairmanship of the Board are renewable subject to the approval of the US President. The renewable terms add to the accountability arrangements between the Fed and the Administration; and
- (c) the Fed is subject to scrutiny by the Office of Inspector General (OIG)<sup>87</sup>, which conducts audits and investigations of programmes and operations of the Board and its delegated functions to FRBs.

70.2 The Fed is ultimately accountable to Congress, which can modify its functions by legislation<sup>88</sup>. In an extreme scenario, Congress can seek legislative changes to abolish the Fed.

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<sup>87</sup> Under the Inspector General Act of 1978, OIG is established as an independent organization within every executive agency to audit and investigate the operations of the agency concerned. Each OIG is headed by an Inspector General who is appointed by the US President and confirmed by the Senate.

<sup>88</sup> Congress has changed the structure and ground rules under which the Fed functions on a number of occasions. Examples include the Humphrey-Hawkins Balanced Growth and Employment Act of 1978, the Monetary Control Act of 1980, the Freedom of Information Act and the Inspector General Act of 1978.

- 70.3 The major accountability arrangements between Congress and the Fed are:
- (a) the appointments of Board members are subject to the advice and consent of the Senate;
  - (b) federal statute requires the Fed to report annually on its activities to the Speaker of the House of Representatives and twice a year to the Banking Committee of Congress on its planned monetary policy;
  - (c) the Chairman of the Board has to appear before Congress every February and July to testify on the state of the US economy and the outlook for monetary policies;
  - (d) Board members and presidents of FRBs could be called upon by Congress to testify before congressional committees on the economy, monetary policy, banking supervision and regulation, consumer credit protection and financial markets; and
  - (e) the Federal Banking Act<sup>89</sup> has brought most of the operations of the Fed under the purview of the General Accounting Office (GAO)<sup>90</sup>.

- 70.4 The Fed provides the public with the following information:
- (a) the Fed's financial statements, annual reports and congressional testimonies made by the Chairman and other Board members; and
  - (b) minutes of FOMC.

70.5 The public can attend Board meetings which are not closed under the legal exemptions defined in the Sunshine Act<sup>91</sup>. However, most of the meetings are usually not open to the public due to the sensitive nature of issues being discussed.

70.6 The Fed's decisions could be subject to judicial review initiated by the financial institutions concerned.

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<sup>89</sup> In 1978, the US President signed the Federal Banking Agency Audit Act which empowers the Comptroller General of the General Accounting Office to audit the Fed, OCC and Federal Deposit Insurance Corporation.

<sup>90</sup> GAO, headed by the Comptroller General, is the investigative arm of Congress. GAO examines the use of public funds, probes for waste, fraud and inefficiency, and evaluates federal programmes and activities. It also provides analyses, recommendations, and other assistance to help Congress make effective oversight, policy, and funding decisions.

<sup>91</sup> Under the Sunshine Act, the public is entitled to the fullest practicable information regarding the decision making processes of the federal government.

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## **71. Operational independence**

71.1 The full term for a Board member is 14 years, and the terms are arranged in such a way that one term expires every two years. The long tenure and staggered terms<sup>92</sup> are designed to help insulate the Board from the US President's control over the Fed and political pressures from the Administration.

71.2 The president of each FRB is appointed by its board of directors, subject to approval of the Board. This procedure should help safeguard the independence of FRBs since their directors represent a cross-section of interests including those of depository institutions, non-financial businesses, labour and the public.

71.3 The Fed is structured to be self-financing in the sense that it meets its operating expenses primarily from the interest income on its holding of US government securities.

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<sup>92</sup> The staggered term system means that the US President can only appoint up to two of the seven Board members during his four-year presidential term.

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## **Part 11 - Office of the Comptroller of the Currency, the United States of America**

### **72. Powers and functions of the Office of the Comptroller of the Currency**

72.1 The Office of the Comptroller of the Currency (OCC) is the oldest federal financial regulatory agency in the United States of America (US). In 1863, the National Currency Act was enacted to establish OCC as a bureau of the Department of the Treasury (the Treasury) and to create the position of the Comptroller of the Currency (the Comptroller) to head OCC in regulating the national banking system.

72.2 The National Currency Act was superseded by the National Bank Act (the Act) in 1864. The Act authorizes the Comptroller to employ examiners to supervise and periodically examine national banks. The Act also gives the Comptroller the authority to regulate the lending and investment activities of national banks.

72.3 As a bureau of the Treasury, OCC is responsible for chartering, regulating and supervising all national banks. It also supervises the federal branches and agencies of foreign banks.

72.4 In regulating national banks, OCC has the power to:

- (a) examine banks;
- (b) approve or deny applications for new charters, branches, capital, or other changes in corporate or banking structure;
- (c) take supervisory actions against banks which do not comply with laws and regulations or engage in unsound banking practices. The agency can remove officers and directors, negotiate agreements to change banking practices, issue "cease and desist" orders<sup>93</sup>, and impose civil money penalties; and
- (d) issue rules and regulations governing their investments and lending activities.

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<sup>93</sup> OCC could issue a "cease and desist" order to stop a national bank from conducting any unsound banking practices, or to force it to comply with a particular banking regulation.

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### **73. Organizational structure**

73.1 OCC is headed by the Comptroller who is appointed by the US President, with the advice and consent of the Senate, for a term of five years<sup>94</sup>. The Comptroller appoints nine Senior Deputy Comptrollers<sup>95</sup> (SDCs) to assist him in carrying out the statutory functions of OCC. These nine SDCs share the following tasks of:

- (a) rendering advice to OCC on legal matters;
- (b) administering the management functions of OCC;
- (c) providing support to OCC's information technology;
- (d) overseeing the national bank appeals process and the Customer Assistance Group<sup>96</sup>;
- (e) advising the Comptroller on media relations, and communications activities and policies;
- (f) managing OCC's economic research and analysis programmes;
- (g) supervising large national banks which are generally involved in sophisticated banking activities;
- (h) supervising mid-size/community banks which are involved in more traditional banking activities and operate over a relatively small geographical area; and
- (i) formulating and disseminating OCC's supervision policies.

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<sup>94</sup> The Comptroller also serves as a director of both the Federal Deposit Insurance Corporation and the Neighbourhood Reinvestment Corporation.

<sup>95</sup> The nine SDCs are (i) the First Senior Deputy Comptroller and Chief Counsel, (ii) the Senior Deputy Comptroller for Management and Chief Financial Officer, (iii) the Chief Information Officer, (iv) the Ombudsman, (v) the Senior Deputy Comptroller for Public Affairs and Chief of Staff, (vi) the Senior Deputy Comptroller for International and Economic Affairs, (vii) the Senior Deputy Comptroller for Mid-Size/Community Bank Supervision, (viii) the Senior Deputy Comptroller for Large Bank Supervision, and (ix) the Senior Deputy Comptroller for Bank Supervision Policy and Chief National Bank Examiner.

<sup>96</sup> The Customer Assistance Group reviews and processes complaints received from customers of national banks.

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73.2 The Executive Committee, which is chaired by the Comptroller and attended by the nine SDCs, provides advice to the Comptroller in managing the operations of OCC, as well as approving policy and project initiatives and the associated use of agency resources. (See Appendix XII for the organizational structure of OCC.)

#### **74. Funding of the Office of the Comptroller of the Currency**

74.1 OCC's operations are funded primarily by semi-annual assessments levied on national banks<sup>97</sup>. For Financial Year<sup>98</sup> 2000-01, semi-annual assessments accounted for US\$395.5 million or 95.1% of OCC's total revenue.

#### **75. Mechanism for approving and controlling expenditure**

##### Budgetary process

75.1 OCC's budgetary process consists of a sequence of steps which starts with the formulation of preliminary expenditure and revenue estimates by the Central Budget Unit for the upcoming financial year. Each division head, i.e. SDC, goes through the preliminary estimates and makes submission to the Central Budget Unit on the budget of his division. The Central Budget Unit reviews the budget submissions and consolidates them into a proposed budget to be approved by the Comptroller.

##### Controlling of expenditure

75.2 The total expenditure of OCC amounted to US\$420.1 million in Financial Year 2000-01. Staff-related costs (salary and benefits) accounted for US\$325.5 million or 77.5% of the total expenditure.

75.3 OCC does not publish any breakdown for capital expenditure in its annual report. As of the date of publication of this report, OCC has not provided us any figures for its capital expenditure.

75.4 OCC's annual financial statements are audited by an independent public accountant firm.

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<sup>97</sup> Assessments are fees paid by national banks to OCC for the costs it incurs on the supervision and administration of the national banking system. OCC bases on the asset size of a national bank to determine the amount of assessments charged on the bank.

<sup>98</sup> Financial Year begins on 1 October and ends on 30 September of the following year.

## **76. Remuneration for the Comptroller and staff**

### Remuneration for the Comptroller

76.1 The salary payable to the Comptroller is approved by Congress. At present, the Comptroller is compensated under the rate of pay for Executive Schedule Level III<sup>99</sup>, which is at US\$138,000. The Comptroller is also entitled to benefits identical to those of regular government employees outside OCC, which include health insurance, life insurance and retirement benefit<sup>100</sup>.

76.2 The adjustment of the salary payable to the Comptroller is subject to Congress's approval. Regarding the salary adjustment mechanism, please refer to paragraphs 69.1-69.5 of Part 10 on pages 82-83.

### Remuneration for staff

76.3 The Comptroller can employ staff to perform the functions of OCC. OCC employed a total staff of 2 861 in June 2002.

76.4 The salaries payable to OCC's staff, including those at the SDC level, are determined by the Comptroller based on recommendations made by the Executive Committee. The salary structure is governed by a pay schedule consisting of nine pay bands and a basic pay supplemented by "locality adjustments"<sup>101</sup> for different regions within the US.

76.5 The annual salary adjustments for OCC's staff are governed by the Financial Institutions Reform, Recovery and Enforcement Act of 1989. The Act allows OCC to break away from the Executive Schedule and offer salaries compatible with those in other federal financial regulatory agencies, such as the Federal Reserve System and the Office of Thrift Supervision. As such, OCC conducts an annual survey of the compensation schemes operated by other federal financial regulatory agencies. The Comptroller, based on the survey results together with other considerations such as job performance and staff retention, determines the adjustments made to the salary of OCC's individual staff member.

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<sup>99</sup> Please see footnote 86 on page 82.

<sup>100</sup> OCC, as a federal government agency, provides two retirement schemes for its staff, namely the Civil Service Retirement System and the Federal Employees Retirement System.

<sup>101</sup> Locality-based adjustments are set at rates determined by surveys conducted in selected localities across the US. Those localities which prove to be significantly further ahead in terms of salaries paid to target occupations in the private sector are established as localities for which there will be locality-based adjustments at rates reflecting the gap. The locality adjustments are to make salaries in the federal government agencies compatible with those in the private sector.

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**77. Accountability arrangements**

77.1 As a bureau of the Treasury, OCC is subject to the general oversight of the Secretary of the Treasury. Furthermore, OCC abides by more federal rules and procedures than other independent financial regulatory agencies.

77.2 The major accountability arrangements between Congress and OCC are:

- (a) the appointment of the Comptroller is subject to the advice and consent of the Senate;
- (b) Congress can call upon the Comptroller to testify before committees on matters related to the national banking system;
- (c) OCC's operations are subject to the audit of the General Accounting Office (GAO)<sup>102</sup>, the investigative arm of Congress, on a periodic basis pursuant to the Banking Agency Audit Act<sup>103</sup>. GAO also conducts benchmark comparison of OCC's performance with that of other federal financial regulatory agencies as well; and
- (d) OCC is required to submit to Congress reports which detail its regulatory activities, and financial and operational performance. In particular, OCC is governed by the Federal Managers' Financial Integrity Act (FMFIA) of 1982 to report on any inefficiency in its operations.

*Statutory requirements under the Federal Managers' Financial Integrity Act*

77.3 FMFIA requires all federal executive agencies, including OCC, to conduct self-evaluation of the adequacy of their internal management controls based on the standards prescribed by the Comptroller General of GAO. Against this, each agency head assesses his agency's ongoing management, accounting and administrative controls, to ensure that:

- (a) obligations and costs comply with the applicable law;
- (b) funds, properties and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- (c) revenues and expenditures are properly recorded and accounted for in accordance with the law.

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<sup>102</sup> For details of GAO, please refer to footnote 90 on page 84.

<sup>103</sup> Please see footnote 89 on page 84.

77.4 The agency heads each submits an annual Statement of Assurance to the US President and Congress, stating whether his internal management controls fully comply with GAO's standards. If not, the Statement has to highlight the material weaknesses in internal management controls and the schedule for correcting these weaknesses. Since OCC is a bureau of the Treasury, the Comptroller submits his annual Statement of Assurance to the Secretary of the Treasury.

77.5 OCC prepares reports on its operational and financial performance on an annual basis. It also compiles reports on the conditions of the national banking system, corporate decisions, legal interpretations, merger activities, information on problem national banks, national bank failures, enforcement actions and the appeals process. These reports, coupled with congressional testimonies made by the Comptroller, are published information and can be accessed through OCC's website.

77.6 The Office of the Ombudsman has been established within OCC to serve as a liaison between the financial industry and OCC on any regulatory matters. In particular, the Ombudsman oversees the national bank appeals process and handles complaints received from customers of national banks.

77.7 OCC's decisions can be subject to judicial review initiated by the financial institutions concerned.

## **78. Operational independence**

78.1 Although OCC is a bureau of the Treasury, the Secretary of the Treasury is prohibited by federal statute from intervening in any matters or proceeding before the Comptroller unless otherwise specifically provided by law. Similarly, the Secretary of the Treasury cannot delay or prevent the issuance of any rule or the promulgation of any regulation by the Comptroller.

78.2 The Comptroller is appointed by the US President and confirmed by the Senate for a term of five years. This gives the Comptroller an added modicum of independence from the Secretary of the Treasury, to whom he reports.

78.3 A separate statute authorizes OCC, along with a number of other financial regulatory agencies, to submit legislative recommendations and testimonies to Congress without review by any other agencies. Nevertheless, OCC provides the Secretary of the Treasury with an advance copy of its recommendations and testimonies for comment.

78.4 OCC's self-financing status provides for the Comptroller's independent authority in setting employee compensation and collecting assessments and other fees to meet the office's expenses in carrying out OCC's functions.

## **Part 12 - Office of Thrift Supervision, the United States of America**

### **79. Powers and functions of the Office of Thrift Supervision**

79.1 The Office of Thrift Supervision (OTS) was established as a bureau of the Department of the Treasury (the Treasury) by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (the Act). The Act stipulates, among other things, the replacement of the Federal Home Loan Bank Board (FHLBB) by OTS as the regulator of the US thrift institutions.

79.2 Before the passage of the Act, FHLBB had operated as the regulator of the thrift industry, chartering and supervising federal saving associations, and insuring deposits in savings associations. The savings and loan crisis of the 1980s resulted in the passage of the Act to abolish FHLBB and replace it with OTS. However, OTS does not assume all of FHLBB's responsibilities and only takes up the role of the primary federal regulator of thrift institutions. The deposit insurance responsibilities of FHLBB have been transferred to the Federal Deposit Insurance Corporation (FDIC).

79.3 While the Act stipulates the replacement of FHLBB by OTS, OTS, as the successor to FHLBB, has its functions prescribed by the Home Owners' Loan Act (HOLA), the same legislation setting out the functions of FHLBB. HOLA stipulates that the statutory functions of OTS are to:

- (a) serve as the primary regulator of all federally chartered savings and loan associations and savings banks, and state chartered savings and loan associations;
- (b) charter federal savings and loan associations and savings banks;
- (c) issue regulations governing the operations of the thrift industry;
- (d) conduct examinations of federally and state chartered savings associations and their affiliates; and
- (e) supervise the compliance with federal laws and regulations and OTS directives, and take measures needed to enforce such compliance and to rehabilitate troubled institutions.



## **80. Organizational structure**

80.1 The chief executive of OTS is the Director, who is appointed by the US President with the advice and consent of the Senate for a term of five years<sup>104</sup>.

80.2 The Director determines the overall policy of OTS and makes final decisions on regulations, policies and administrative adjudications governing the thrift industry and on many measures affecting individual institutions. The Director is assisted by a Deputy Director who manages day-to-day operations through four major units, namely the Office of Supervision, the Office of Chief Counsel, the Office of Information Systems, Administration and Finance, and four regional offices. (See Appendix XIII for the organizational structure of OTS.)

## **81. Funding of the Office of Thrift Supervision**

81.1 OTS's operations are funded primarily by the assessments levied on thrifts. These assessments are based on each institution's size, financial conditions, and the complexity of its operations. For Financial Year<sup>105</sup> 2001-02, assessments accounted for US\$105.4 million or 87.8% of OTS's total revenue.

81.2 OTS also receives revenue from examination, application and security filing fees, as well as interest and rental income.

81.3 Federal statute stipulates the authority of the Director to determine the rates of assessments and fees charged on the thrift institutions which OTS regulates.

## **82. Mechanism for approving and controlling expenditure**

### Budgetary process

82.1 OTS's financial staff start the budgetary process with the issuance of a baseline budget projection for the upcoming financial year to the Washington head-office and the four regional offices. These offices make submissions on the operating and capital expenditure, which are subsequently reviewed and consolidated by the Chief Financial Officer. The consolidated budget is subject to the approval of the Director, taking into account factors such as OTS's goals and work priorities, and estimated revenue to be collected from the thrift industry.

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<sup>104</sup> The Director also serves on the Board of FDIC.

<sup>105</sup> Financial Year begins on 1 October and ends on 30 September of the following year.

82.2 As for capital expenditure, it follows the same approval procedure as that for operating expenditure.

#### Controlling of expenditure

82.3 OTS's total expenditure in Financial Year 2001-02 amounted to US\$121.1 million, of which staff-related costs (salary and benefits) accounted for US\$90.8 million or 75.0%.

82.4 OTS's capital expenditure amounted to US\$826,000 in Financial Year 2001-02.

82.5 OTS's annual financial statements are subject to audit by an independent public accounting firm.

### **83. Remuneration for the Director and staff**

#### Remuneration for the Director

83.1 The salary payable to the Director is approved by Congress. At present, the Director is compensated under the rate of pay for Executive Schedule Level III<sup>106</sup>, which is at US\$138,000. The Director is also entitled to benefits identical to those of other staff, which include health insurance, life insurance and retirement benefit<sup>107</sup>.

83.2 The adjustment of the salary payable to the Director is subject to Congress's approval. Regarding the salary adjustment mechanism, please refer to paragraphs 69.1- 69.5 of Part 10 on pages 82-83.

#### Remuneration for staff

83.3 The Director has the statutory authority of employing staff to perform the functions of OTS. OTS employed a staff of about 955 people in July 2002.

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<sup>106</sup> Please refer to footnote 86 on page 82.

<sup>107</sup> As a federal government agency, OTS has two retirement schemes, namely the Civil Service Retirement System and the Federal Employees Retirement System.

83.4 The salaries payable to OTS's staff are determined by the Director. Annual salary adjustments are governed by the Act. The Act allows OTS and other financial regulatory agencies to break away from the Executive Schedule and to offer salaries compatible with those in other federal financial regulatory agencies, such as the Federal Reserve System (Fed) and the Office of the Comptroller of the Currency. As such, OTS adjusts its salary structure each year to make it compatible with that of other federal financial regulatory agencies. Within the schedule, the Director also takes into account other factors such as job performance and the salary budget when adjusting the salaries of OTS's staff.

#### **84. Accountability arrangements**

84.1 OTS is subject to the general oversight of the Treasury, and the major accountability arrangements between them are:

- (a) OTS is required to provide financial information to the Treasury on a monthly basis to be included in the latter's consolidated financial reports. On a quarterly basis and at the fiscal year-end, the Chief Financial Officer of OTS certifies to the Treasury the accuracy of the financial information provided; and
- (b) OTS, as a federal executive agency, abides by more federal rules and procedures than other independent financial regulatory agencies such as the Fed and FDIC.

84.2 OTS is accountable to Congress through a variety of channels:

- (a) the appointment of the Director is subject to the advice and consent of the Senate;
- (b) Congress can call upon the Director and other senior staff to testify before committees on OTS's operations and matters of legislative concern;
- (c) the congressional committees or any member of Congress can request the General Accounting Office (GAO)<sup>108</sup> or the Inspector General of the Treasury to conduct a review of OTS's operations; and
- (d) OTS is required to submit to Congress reports which detail its regulatory activities, and financial and operational performance. In particular, OTS is governed by the Federal Managers' Financial Integrity Act (FMFIA) of 1982 to report on any inefficiency in its operations.

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<sup>108</sup> For details of GAO, please refer to footnote 90 on page 84.

*Statutory requirements under the Federal Managers' Financial Integrity Act*

84.3 FMFIA requires all federal executive agencies, including OTS, to conduct self-evaluation of the adequacy of their internal management controls based on the standards prescribed by the Comptroller General of GAO. The details concerning how OTS conducts the self-evaluation exercise can be referred to paragraphs 77.3-77.4 on pages 91-92.

84.4 OTS is covered by the Administrative Procedures Act whereby a person aggrieved by an agency action is entitled to apply for judicial review. OTS's enabling legislation (i.e. HOLA) also provides for a thrift institution to seek judicial review of OTS's particular decision, such as the appointment of a receiver and the issuance of enforcement orders.

84.5 OTS provides the public with a variety of information, including its financial statements, annual reports and congressional testimonies made by the Director and other senior staff.

## **85. Operational independence**

85.1 Although OTS is a bureau of the Treasury, the Secretary of the Treasury is prohibited by federal statute from intervening in any matter or proceeding before the Director unless otherwise authorized by law. Similarly, the Secretary of the Treasury cannot delay or prevent the issuance of any rule or promulgation of any regulation by OTS.

85.2 The Director is appointed by the US President and confirmed by the Senate for a term of five years. This procedure gives the Director an added modicum of independence from the Secretary of the Treasury, to whom he reports.

85.3 A separate statute authorizes OTS, along with a number of other financial regulatory agencies, to submit legislative recommendations and testimonies to Congress without review by any other agencies. Nevertheless, OTS provides the Secretary of the Treasury with an advance copy of its recommendations and testimonies for comment.

85.4 OTS's self-financing status provides for the independent authority of the Director in setting employee compensation and collecting assessments and fees to meet the office's expenses in carrying out OTS's functions.

## **Part 13 - Federal Deposit Insurance Corporation, the United States of America**

### **86. Powers and functions of the Federal Deposit Insurance Corporation**

86.1 The Federal Deposit Insurance Corporation (FDIC) is an independent federal government agency of the United States of America (US), which insures deposits in most commercial banks and savings associations<sup>109</sup>. FDIC was established in 1933 when the Federal Reserve Act was amended<sup>110</sup> to create a temporary agency to insure deposits and promote safe and sound banking practices. The establishment of FDIC at the time was to restore the public confidence in the US banking system after the failure of some 9 000 banks in the aftermath of the 1929 stock market crash. FDIC was subsequently made a permanent corporation by the enactment of the Banking Act of 1935.

86.2 The Banking Act of 1935 was superseded by the Federal Deposit Insurance Act (the Act), which was enacted in 1950 to revise and consolidate earlier FDIC legislation into one single act. The Act embodies the authority of FDIC in performing its functions.

86.3 The statutory functions of FDIC are to:

- (a) operate two insurance funds to insure deposits up to US\$100,000 in most commercial banks and savings associations - the Bank Insurance Fund (BIF) insures commercial banks and the Savings Association Insurance Fund (SAIF) insures saving associations<sup>111</sup>;
- (b) promote the safety and soundness of insured depository institutions and the US financial system by identifying, monitoring and addressing risks to the two deposit insurance funds;
- (c) arrange a resolution for each failing institution. FDIC works with the chartering agencies, such as the Office of the Comptroller of the Currency (OCC), to deal with failing institutions. Once an institution is closed, FDIC acts as the receiver and liquidates the assets of the failed institutions; and
- (d) regulate some 6 000 state chartered "non-member" banks. State chartered non-member banks are commercial and savings banks which are not members of the Federal Reserve System (Fed).

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<sup>109</sup> All federally chartered financial institutions must have deposit insurance. However, some states permit a state chartered commercial bank or savings association to operate without deposit insurance.

<sup>110</sup> In 1933, US President Franklin Roosevelt signed the Banking Act and section 8 of which created FDIC through the amendment to the Federal Reserve Act.

<sup>111</sup> In 1989, the Financial Institutions Reform, Recovery and Enforcement Act was enacted to transfer the responsibility of providing insurance protection for deposits in savings associations to FDIC from the now defunct Federal Home Loan Bank Board.

## **87. Organizational structure**

### The Board of Directors

87.1 The Board of Directors (the Board) is responsible for determining FDIC's policy objectives and strategies, as well as monitoring its operations.

### *Membership of the Board*

87.2 Federal statute stipulates that no more than three out of the five Board members are of the same political party.

### *Appointment of the Board members*

87.3 The Board consists of five members and two of them - the Comptroller of OCC and the Director of the Office of Thrift Supervision (OTS)<sup>112</sup> - are ex officio members. The other three Board members are appointed by the US President with the advice and consent of the Senate. The appointed members are usually from the banking sector.

87.4 With the advice and consent of the Senate, the President designates one of the three appointed Board members as the Chairman and a second as the Vice Chairman of the Board.

87.5 The three appointed Board members all serve a term of six years. After serving their full terms, they cannot be re-appointed. Nevertheless, they can continue to serve in their offices until their successors have been appointed and qualified.

87.6 There are no statutory rules governing the removal of the Board members.

### Management structure

87.7 The Board is assisted by seven divisions and five offices, which are responsible for day-to-day operations of FDIC. (See Appendix XIV for the organizational structure of FDIC)

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<sup>112</sup> As a bureau of the Department of the Treasury, OCC is headed by the Comptroller who is responsible for regulating the national banking system. OTS, headed by the Director, is also a bureau of the Department of the Treasury. OTS serves as the primary regulator of all federally chartered and most state chartered thrift institutions.

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87.8 The FDIC bylaws authorize the Board to establish standing or special committees and to assign to those committees such functions and duties as the Board sees fit. As such, FDIC has established a number of standing committees consisting of FDIC's Directors and other senior staff. The principal standing committees are the Case Review Committee, the Audit Committee, the Supervision Appeals Review Committee and the Assessment Appeals Committee.

## **88. Funding of the Federal Deposit Insurance Corporation**

88.1 FDIC's funding comes primarily from the income of the two insurance funds (BIF and SAIF) and deposit insurance assessments paid by the insured financial institutions.

### Sources of income

88.2 For Financial Year<sup>113</sup> 2001, the total revenue of BIF and SAIF amounted to US\$2.0 billion and US\$733.1 million respectively.

88.3 Both BIF and SAIF derive most of its income from earnings on investment in US Treasury Securities. In Financial Year 2001, BIF's investment income amounted to US\$1.9 billion or 95.8% of its total revenue, while the corresponding figures for SAIF were US\$685.4 million and 93.5%.

88.4 Another source of income for BIF and SAIF is deposit insurance assessments. In Financial Year 2001, BIF received US\$47.8 million from deposit insurance premiums paid by insured financial institutions, representing 2.4% of its total revenue. The corresponding figures for SAIF were US\$35.4 million and 4.8%.

## **89. Mechanism for approving and controlling expenditure**

### Budgetary process

89.1 When FDIC prepares its budget, resource requirements for the upcoming financial year are identified through a series of planning and budget meetings attended by FDIC's senior managers. The meetings end with a proposed budget to be submitted to the Board of Directors for approval.

89.2 As for capital expenditure, it follows the same approval procedure as that for operating expenditure.

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<sup>113</sup> Financial Year begins on 1 January and ends on 31 December of the same year.

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### Controlling of expenditure

89.3 The total expenditure of BIF amounted to US\$2.6 billion in Financial Year 2001. The largest cost item was the provision for insurance losses, which accounted for US\$1.8 billion or 68.7% of BIF's total expenditure. Operating expenses accounted for US\$785.9 million or 30.7% of the total expenditure<sup>114</sup>.

89.4 The total expenditure of SAIF amounted to US\$564.1 million in Financial Year 2001. The largest cost item was the provision for insurance losses, which accounted for US\$443.3 million or 78.6%. Operating expenses accounted for US\$101.6 million or 18.1% of the total expenditure.

89.5 FDIC's capital expenditure amounted to US\$50 million in Financial Year 2001.

89.6 The Comptroller General of the General Accounting Office<sup>115</sup> (GAO) conducts an annual audit of FDIC's financial statements, and the audit report is submitted to Congress for scrutiny. The US President, the Secretary of the Treasury and the FDIC Chairman also receive a copy of the audit report.

## **90. Remuneration for Directors and staff**

### Remuneration for Directors

90.1 The salaries payable to FDIC's non-ex officio Directors on the Board are approved by Congress. The FDIC Chairman is placed at a pay scale equivalent to Executive Schedule Level III<sup>116</sup>, which is at US\$138,000. Salaries of the Vice Chairman and the other appointed Board member are both set at Executive Schedule Level IV, which is at US\$130,000. They are also entitled to benefits identical to those of regular government employees outside FDIC, which include health insurance, life insurance and retirement benefit<sup>117</sup>.

90.2 The adjustments of salaries payable to FDIC's Board members are subject to Congress's approval. Regarding the salary adjustment mechanism, please refer to paragraphs 69.1-69.5 of Part 10 on pages 82-83.

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<sup>114</sup> As of the date of publication of this report, FDIC has not provided us with the figures for the amount of staff-related costs incurred by BIF and SAIF.

<sup>115</sup> For details of GAO, please refer to footnote 90 on page 84.

<sup>116</sup> Please see footnote 86 on page 82.

<sup>117</sup> FDIC, as a federal government agency, provides two retirement schemes for its staff, namely the Civil Service Retirement System and the Federal Employees Retirement System.



### Remuneration for staff

90.3 The Board of Directors employs staff to carry out the functions of FDIC. As at June 2002, 6 007 people were employed by FDIC.

90.4 FDIC's staff members are remunerated under pay schedules different from those for Directors. Apart from basic pay, they also receive "locality adjustments"<sup>118</sup> for different regions of the US.

90.5 While FDIC's Board members remunerated under the Executive Schedule are subject to the adjustment mechanism explained in paragraph 90.2, staff members are governed by the Financial Institutions Reform, Recovery and Enforcement Act of 1989, which stipulates that the federal financial regulatory agencies can offer salaries competitive with one another. As such, FDIC adjusts its salary structure each year to make it comparable with that of the Fed, OCC and OTS.

## **91. Accountability arrangements**

91.1 FDIC is accountable to the Administration through the following channels:

- (a) FDIC submits to the Department of the Treasury a quarterly report which details its operating plans and financial forecasts. It also submits the same report to the Office of Management and Budget<sup>119</sup>; and
- (b) the Government Performance and Results Act of 1993 requires FDIC to develop a strategic plan, which outlines its mission, goals and objectives, as well as actual results in such a way as to be measurable.

91.2 FDIC is subject to the scrutiny of the Office of Inspector General (OIG)<sup>120</sup>, which conducts audits and investigations of the programmes and operations of FDIC.

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<sup>118</sup> Please see footnote 101 on page 89.

<sup>119</sup> The Office of Management and Budget, which is staffed by accountants, economists, and tax lawyers, assists the US President in overseeing the preparation of the federal budget and supervising the operations of the executive agencies.

<sup>120</sup> For details of OIG, please refer to footnote 87 on page 83.

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91.3 The FDIC Chairman and other senior staff frequently testify before the congressional banking committees. FDIC is also required to submit current and projected financial statements to Congress. Same as the Fed and OCC, FDIC's operations are subject to the audit of GAO on a periodic basis pursuant to the Banking Agency Audit Act<sup>121</sup>. In addition, Congress can seek legislative changes to modify the functions of FDIC.

91.4 FDIC is accountable to the public through a variety of channels:

- (a) FDIC compiles reports on deposit insurance and the financial services industry on a regular basis. In addition, FDIC prepares annual report, financial statements, as well as strategic and performance plans on an annual basis. These documents, coupled with congressional testimonies made by FDIC's Board members, are available to the general public;
- (b) FDIC's decisions can be subject to judicial review initiated by the financial institutions concerned; and
- (c) the Office of the Ombudsman has been established within FDIC, which serves as a neutral and confidential source of assistance to the financial industry. In particular, the Ombudsman oversees the appeals process to ensure its fairness, efficiency and effectiveness.

## **92. Operational independence**

92.1 FDIC is established as an independent government agency by federal statute, and operates according to the Federal Deposit Insurance Act. These help safeguard the independence of FDIC from other federal departments as well as the immunity from political interference with its operations.

92.2 FDIC's self-financing status provides for the independent authority of the Board in setting employee compensation and collecting premiums from insured financial institutions to meet the office's expenses in carrying out its functions.

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<sup>121</sup> Please see footnote 89 on page 84.

## **Part 14 - Monetary Authority of Singapore, Singapore**

### **93. Powers and functions of the Monetary Authority of Singapore**

93.1 The Monetary Authority of Singapore (MAS) is the central bank of Singapore which was established in 1971 through enacting the Monetary Authority of Singapore Act (the Act). Before the formation of MAS, the various monetary functions associated with a central bank had been performed by several government departments and agencies. MAS was set up to consolidate these functions and to facilitate the development of a more coherent policy on banking and monetary matters.

93.2 Major functions of MAS are:

- (a) conducting monetary and exchange rate policies conducive to the growth of the economy;
- (b) supervising banking, insurance, securities, futures, fund management and unit trusts industries;<sup>122</sup>
- (c) developing strategies in partnership with the private sector to promote Singapore as an international financial centre; and
- (d) acting as the banker and financial agent of the government.

### **94. Organizational structure**

#### The Board of Directors

##### *Functions*

94.1 The Act provides for the establishment of a board of directors (the Board) which is responsible for formulating banking and credit policies, administering the affairs of MAS, and updating the government of its financial policies.

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<sup>122</sup> MAS is vested with the powers to issue directives and guidelines to financial institutions and to monitor their operations.

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*Membership of the Board*

94.2 The Act stipulates that:

- (a) the Chairman<sup>123</sup> and the Board members are appointed by the President of Singapore on recommendation of the Cabinet; and
- (b) the Board consists of no fewer than four and no more than nine Board members<sup>124</sup>, one of whom is the Deputy Chairman.

94.3 The Board members so appointed:

- (a) should not act as delegates on the Board from any commercial, financial, agricultural, industrial or other interests with which they may be connected; and
- (b) are paid by the funds of MAS such remuneration and allowances as determined by the President of Singapore.

94.4 Currently, the Board has six members — four from the government and two from the legal service field.

94.5 As of the date of publication of this report, MAS has not provided us with information regarding whether the Board members receive any financial rewards.

94.6 The Board members hold office for a term not exceeding three years and are eligible for reappointment. Under the Act, the President may terminate the office of any director who:

- (a) resigns from his office;
- (b) becomes of unsound mind or incapable of carrying out his duties;
- (c) becomes bankrupt;
- (d) is convicted of an offence involving dishonesty, fraud or moral turpitude;
- (e) is guilty of serious misconduct in relation to his duties;
- (f) is absent from three consecutive meetings of the Board; or
- (g) fails to comply with the obligations of disclosing the nature of his interest at the first meeting of the Board.

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<sup>123</sup> The current Chairman of MAS is Lee Hsien Loong who also serves as both the Deputy Prime Minister and the Minister of Finance.

<sup>124</sup> The maximum number of Board members grew from seven to nine in 1998 to strengthen its management role.

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### *Board meetings*

94.7 The Act requires that the Chairman should summon meetings as often as may be required but not less frequently than once in every three months.

### Senior management

94.8 The day-to-day administration of MAS is performed by the Managing Director, who is accountable to the Board for his decisions. The Managing Director, an employee of MAS, is appointed by the President<sup>125</sup> who also decides his terms and conditions of employment. There are two Deputy Managing Directors who are responsible for overseeing two business groups. (See Appendix XV for the organizational structure of MAS.)

## **95. Funding of the Monetary Authority of Singapore**

95.1 Activities of MAS are funded by its own capital and reserves, which amounted to S\$13.96 billion in March 2001<sup>126</sup>. In accordance with the Statutory Corporations (Contributions to Consolidated Fund) Act, 20% of the net investment returns of MAS's capital and reserves should be returned to the government. The net investment returns amounted to S\$2.065 billion<sup>127</sup> in Financial Year<sup>128</sup> 2000-01, which implied that S\$413 million should be returned to the government. Nonetheless, as approved by the Board<sup>129</sup>, MAS in fact transferred an amount of S\$1.59 billion to the government.

## **96. Mechanism for approving and controlling expenditure**

### Budgetary process

96.1 The Finance Department of MAS prepares a budget incorporating estimates of income and expenditure of all departments for the ensuing financial year and presents it to the Board for approval. If the budget is supported, it will be submitted to the President for his approval under Article 22B of the Constitution. The budget approved by the President is published in the Gazette.

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<sup>125</sup> He concurs with the advice or recommendation of the Public Service Commission which is established under the Constitution of Singapore.

<sup>126</sup> Total assets of MAS in March 2001 were S\$129.5 billion.

<sup>127</sup> Financial institutions operating in Singapore are required to pay fees.

<sup>128</sup> Financial year begins on 1 April and ends on 31 March of the following year.

<sup>129</sup> MAS has not provided an explanation of the rationale for this financial arrangement.

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### Controlling of expenditure

96.2 In Financial Year 2000-01, the total expenditure amounted to S\$116.1 million. The personnel expenditure was S\$88.2 million, which accounted for 76% of the total expenditure.

96.3 As of the date of publication of this report, MAS has not provided us with information on the approval mechanism and relevant statistics of capital expenditure.

96.4 To ensure proper financial control, the Internal Audit Department is established within MAS to audit its own operations. Under the Act, the accounts of MAS should also be audited by the Auditor-General<sup>130</sup>. Furthermore, the Audit Committee<sup>131</sup> within MAS performs an audit as well, focusing on the adequacy of MAS's internal controls and audit resources, the scope and results of the internal and external auditors' work and the integrity of the financial reporting process.

## **97. Remuneration for staff**

### Powers to appoint and determine staff remuneration arrangements

97.1 MAS is empowered to appoint employees to perform its duties. In March 2001, the staff establishment was 823.

97.2 Under the Act, MAS determines all matters relating to staff remuneration packages. Both remuneration and allowances paid by MAS are not tied to its profit.

### Procedures of reviewing staff remuneration arrangements

97.3 The salary policy of MAS is to award remuneration packages that are competitive with those of the financial sector. Hence, MAS conducts its own annual salary reviews and participates in salary surveys conducted by professional consultancy firms for the financial sector. MAS bases the adjustment of staff remuneration on these results so that it is comparable to that of the financial sector in Singapore.

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<sup>130</sup> The Auditor-General is appointed by the President of Singapore to audit and report on the accounts of the ministries and certain statutory boards.

<sup>131</sup> The Audit Committee, comprising three non-executive MAS Board members, was established in May 2001.

97.4 Staff performance is appraised during the annual appraisal exercise. Staff ability and contributions are taken into account when considering salary increases and performance bonuses awarded. Staff who perform well receive variable bonuses.

97.5 The remuneration packages for Executive Director level and above are recommended by a staff committee, comprising selected senior management staff and chaired by the Managing Director. The composition of the staff committee is approved by another staff committee, comprising the Chairman and selected Board members.

## **98. Accountability arrangements**

98.1 MAS is accountable to the Ministry of Finance. At present, the post of the Chairman of MAS is concurrently taken up by the Minister of Finance. The accountability arrangements between MAS and the government are:

- (a) Under the Act, MAS is required to update the government of its financial policies;
- (b) The Board members and the Executive Directors are appointed by the President. Currently, four out of the six Board members are from the government; and
- (c) MAS should, within six months from the close of its financial year, transmit to the President:
  - (i) a copy of the annual accounts certified by the Auditor-General, and those accounts published in the Gazette; and
  - (ii) a report by the Board on the working of MAS throughout the financial year.

98.2 MAS is accountable to the legislature in the following ways:

- (a) Members of Parliament can raise questions with the Minister of Finance on the performance of MAS. Seven parliamentary questions on MAS were asked in 2001;<sup>132</sup> and
- (b) The Act requires that MAS should prepare the annual accounts and annual report to be presented to Parliament.

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<sup>132</sup> These questions related to the use of banks' names, the roles of finance companies and electronic payments, etc.

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98.3 MAS keeps the public informed of its work through its annual accounts and annual reports which are made available to the public.

**99. Operational independence**

99.1 According to MAS, it enjoys considerable operational autonomy. Hence, operational independence is not a concern.



## **Part 15 - The Government of Singapore Investment Corporation, Singapore**

### **100. Powers and functions of the Government of Singapore Investment Corporation**

100.1 The Government of Singapore Investment Corporation (GIC), which was established under the Companies Act as a private company since its inception in 1981,<sup>133</sup> is wholly owned by the government. According to GIC, this arrangement allows it to operate as a global fund manager, and also allows the government to have oversight over the management of the country's reserves.

100.2 The Constitution of Singapore stipulates that GIC is a government company, which is known as a "Fifth Schedule" company. (See the following paragraphs for the consequences arising from GIC's status being a "Fifth Schedule" company.)

100.3 GIC is responsible for managing the country's foreign exchange reserves, investments in equities, fixed income and money market instruments, real estate and special investments<sup>134</sup>. At present, Singapore's foreign exchange reserves amount to over US\$100 billion.

### **101. Organizational structure**

#### The Board of Directors

##### *Functions*

101.1 The Board of Directors (the Board) is responsible for determining GIC's policy objectives and strategies, as well as monitoring its operations.

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<sup>133</sup> The formation of GIC had its roots in the late 1970s. At that time, Singapore had a high saving rate among a young population, which was expected to contribute to the country's balance of payments surpluses for some time. The country's foreign exchange reserves were also expected to grow continuously. Under such circumstances, GIC was established in 1981.

<sup>134</sup> These include venture capital, infrastructure, mezzanine financing and corporate restructuring.

### *Membership of the Board*

101.2 The Board consists of 11 members: the Chairman, the Deputy Chairman and nine Directors. The current Chairman of GIC is Senior Minister Lee Kuan Yew and the Deputy Chairman is Deputy Prime Minister Lee Hsien Loong. The Directors are professionals in various areas: two from the government, three from the banking sector, two from the commercial field, and two from GIC's senior management staff (i.e. the Group Managing Director and the Managing Director of the Public Markets Division.)

101.3 Owing to GIC's status of a "Fifth Schedule" company, the Board and the Group Managing Director are appointed or removed by the President of Singapore. Under the Constitution, it is obligatory for the President to consult the Council of Presidential Advisers<sup>135</sup> (CPA) before he appoints or removes any Principal Officials of the government and government companies including GIC.

101.4 As of the date of publication of this report, GIC has not provided us with information whether the Board members receive any financial rewards.

101.5 The Chairman, Deputy Chairman and Directors are appointed for a term not exceeding three years and are eligible for reappointment. There are no statutory rules governing the removal of the Board members.

### Senior management

101.6 The day-to-day operations of GIC are managed by the Group Managing Director's Office. At the same time, GIC Real Estate Limited<sup>136</sup> and GIC Special Investments Limited<sup>137</sup> have their own Boards for overseeing their respective businesses. (See Appendix XVI for the organizational structure of GIC.)

## **102. Funding of the Government of Singapore Investment Corporation**

102.1 GIC operates as a global fund manager, and is paid a management fee by the government.

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<sup>135</sup> CPA comprises six members, of whom two are approved by the President at his discretion, two are the Prime Minister's nominees, one is the Chief Justice's nominee and the sixth is the nominee of the Chairman of the Public Service Commission. Members are appointed on a six-year term on their first appointment. They are eligible for re-appointment for further terms of four years.

<sup>136</sup> It is the real estate arm of GIC, which invests real estate worldwide.

<sup>137</sup> It is the private equity investment arm of GIC.

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### **103. Mechanism for approving and controlling expenditure**

#### Budgetary process

103.1 GIC is required to submit its proposed budget to the President for approval. The financial accounts are accompanied by a declaration from both the Chairman of the Board and the Group Managing Director on whether there has been, or is likely to be, any drawing on reserves not accumulated by the company during the current term of office<sup>138</sup> of the government.

103.2 Article 22D of the Constitution stipulates that the President may disapprove the budget of a government company if the budget is likely to draw on reserves which are not accumulated by that company during the current term of office of the government. In that case, the government company may incur a total expenditure not exceeding the amount provided in the approved budget for the preceding financial year.

#### Controlling of expenditure

103.3 GIC has not published any annual reports and financial accounts. Hence, information on the approval mechanism and the relevant statistics of the total expenditure and capital expenditure are not available to the public.

103.4 The Internal Audit Department is established to provide an independent appraisal of financial control, corporate governance processes and risk management within GIC. In addition, the accounts of GIC are examined by both the Auditor-General<sup>139</sup> and CPA.

### **104. Remuneration for staff**

104.1 GIC is empowered to employ staff to perform its duties. The current staff establishment of GIC is over 700.

104.2 GIC can offer competitive staff remuneration packages to attract and keep its staff. GIC's reward terms are comparable to those offered by private institutions in international financial centres where GIC has operations. GIC's pay package consists of a fixed pay (i.e. basic monthly pay) and a variable pay which may be awarded to individual staff once a year based upon performance.

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<sup>138</sup> The term of the government is six years.

<sup>139</sup> The Auditor-General is appointed by the President under Article 148F of the Constitution to audit and report on the accounts of the ministries, statutory boards and GIC.

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104.3 Recommendations on remuneration packages for senior staff are subject to approval by a GIC Remuneration Committee which comprises members of the Board.

## **105. Accountability arrangements**

105.1 GIC is accountable through the Ministry of Finance to the President by the following channels:

- (a) The budget of GIC requires the approval of the President;
- (b) GIC should present to the President a full and audited statement showing the revenue received and expenditure incurred during a financial year, within six months after the close of that financial year; and
- (c) GIC should provide the President, at his request, with any information concerning its operations.

105.2 Information on the accountability arrangements between GIC and Parliament is scant. Nonetheless, in May 2001, a parliamentary question was raised about the disclosure of the annual accounts of GIC. A member of Parliament asked Lee Hsien Loong, the Deputy Chairman of GIC, to explain why the annual accounts of GIC were not disclosed to the public. Lee replied that it was not in the people's interests and nation's interests for GIC to detail its assets and annual returns. Publishing this information would make it easier for speculators to attack the Singaporean currency. In addition, proper control and monitoring systems were in place governing the use of the country's foreign exchange reserves.

105.3 There were discussions in May 2001 about GIC being secretive as its annual accounts and annual reports were not made available to the public. In response to the public concerns, the Chairman of GIC, Lee Kuan Yew, explained that this arrangement could safeguard the people's interests. The government does not plan to disclose information on GIC's operations and annual accounts.

## **106. Operational independence**

106.1 As of the date of publication of this report, GIC has not provided us with information on the issue of its operational independence.

## **Part 16 - Analysis**

### **107. Comparative analysis of the authorities studied**

107.1 The findings of this study are summarised in the Table on pages 121-128, which compares the governance of the Hong Kong Monetary Authority (HKMA) with comparable authorities in Hong Kong and overseas jurisdictions.

### **108. References for Hong Kong**

108.1 The governance of HKMA has been discussed by Members at meetings of the Legislative Council (LegCo) and the Financial Affairs Panel. In particular, they have expressed concerns about the governance of HKMA in respect of:

- (a) powers and functions;
- (b) funding mechanism;
- (c) remuneration package for the Chief Executive of HKMA;
- (d) efficiency of the Exchange Fund Advisory Committee (EFAC) in discharging its functions;
- (e) accountability arrangements; and
- (f) impact of the accountability system for Principal Officials on the governance of HKMA.

108.2 Based on the findings in this study, the following paragraphs highlight the issues which Members may wish to consider when deliberating on the governance of HKMA under the new accountability system for Principal Officials in the Hong Kong Special Administrative Region.

## Powers and functions

### *Regulatory framework*

108.3 The powers and functions of Monetary Authority (MA) are covered in two pieces of legislation, namely the Banking Ordinance (BO) and the Exchange Fund Ordinance (EFO). This arrangement is not uncommon in local authorities where the statutory powers are given to the heads of the authorities under various pieces of legislation.

108.4 BO details the powers and functions of MA relating to the regulation of the banking sector, whereas EFO stipulates MA to (a) assist the Financial Secretary (FS) in the performance of his functions under EFO, (b) perform such functions as FS may direct, and (c) perform functions imposed on or assigned to MA by any other Ordinance. It is noted that there is a growing trend for regulatory bodies to be subject to specific legislation governing their operations, including their powers and functions. The merits of this arrangement are, among other things, the clarity of their objectives and powers, as well as the integrity of the way they carry out their functions.

### *Powers and functions of the Hong Kong Monetary Authority*

108.5 HKMA has expanded its functions since its inception in 1993, noticeably those functions relating to enhancing and developing Hong Kong's financial infrastructure.<sup>140</sup> In turn, the number of staff increased from 289 at end-1993 to around 580 at end-2002. As a result, the staff cost rose from HK\$191 million in 1994 to HK\$480 million in 2001.<sup>141</sup>

108.6 The additional functions taken up by HKMA are not specifically laid out in EFO and BO. In fact, EFO only prescribes the primary and secondary uses of EF. The primary purpose stipulates the use of EF to affect the exchange value of the Hong Kong dollar. The secondary purpose provides for FS to use EF for maintaining the stability and integrity of the monetary and financial systems of Hong Kong, with a view to maintaining Hong Kong as an international centre.

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<sup>140</sup> These include the development of Real Time Gross Settlement in 1996 and the US dollar clearing system in 2000.

<sup>141</sup> As HKMA was established in April 1993, a comparison is made between the 1994 and 2001 figures.

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(a) Foreign exchange reserves management and banking regulation

108.7 The amendment of EFO in 1992, leading to the establishment of HKMA, enables the Administration to bring the banking supervision under the ambit of EF. At present, HKMA is responsible for both assisting FS in the control of Hong Kong's foreign exchange reserves and the regulation of the banking industry. In overseas jurisdictions, these two functions are performed by separate authorities. In fact, prior to the establishment of HKMA in 1993, these two functions were also performed by the Office of the Exchange Fund and the Office of the Commissioner of Banking respectively.

108.8 The management of foreign exchange reserves and the regulation of the banking sector are indirectly related since the stability of the exchange value of a currency hinges, among other things, on a sound and stable financial system. Therefore, this might be one of the intentions of placing foreign exchange reserves management and banking supervision under HKMA.

108.9 The management of foreign exchange reserves and the regulation of the banking sector are performed by different authorities in overseas jurisdictions. In the United States of America (US), the Department of the Treasury is responsible for managing foreign exchange reserves, while the Federal Reserve System (Fed), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC) share the task of regulating the banking sector. In the United Kingdom (UK), HM Treasury is entrusted with managing foreign exchange reserves, whereas the Financial Services Authority (FSA) is the regulator of the financial industry. In Singapore, the Government of Singapore Corporation Investment (GIC) is tasked with investing the country's reserves, while the Monetary Authority of Singapore (MAS) regulates the banking industry.

108.10 The arrangements in overseas jurisdictions might reflect the need for different professionalism for the management of foreign exchange reserves and the regulation of the banking sector. The merit of having separate authorities is that they can focus their efforts exclusively on the specific market environment and market participants involved in each of these two functions, thus enhancing their response to market contingencies.

(b) Prudent supervision and conduct regulation

108.11 The issue of single- versus multiple-regulator regimes is also relevant in the regulation of the increasing engagement of various business operations by a financial institution. In Hong Kong, the supervision of the multi-business operation of a financial institution by HKMA covers both prudential supervision and conduct regulation. Prudential supervision aims primarily at ensuring that the supervised institutions have adequate capital and liquidity to discharge their liabilities so as to avoid a systemic crisis. Conduct regulation focuses on the day-to-day operations of the institutions and the compliance with the standards imposed in the relevant legislation, codes and guidelines.

108.12 Prudential supervision and conduct regulation are two different areas of specialization and as such, the US has adopted a multiple-regulator regime under which the Securities Exchange Commission regulates securities activities and the financial regulatory authorities supervise banking activities. In comparison, the UK has opted for a single-regulator regime made possible by the enactment of the Financial Services and Markets Act in 2000, which provides for the establishment of FSA as the single regulator of all financial services. Nonetheless, the FSA is of the view that prudential supervision and conduct regulation are two different areas of specialization that should be conducted by separate bodies<sup>142</sup>.

#### Funding mechanism

108.13 There are five funding mechanisms identified from the authorities covered in this study:

- (a) financing by foreign exchange reserves as in the case of HKMA;
- (b) receiving an initial capital grant and then operating on a self-financing basis through investment returns generated from the capital grant, and revenues from services provided. Examples are the Mandatory Provident Fund Schemes Authority (MPFA), the Office of the Telecommunications Authority (OFTA), the Bank of England (the Bank) and MAS;
- (c) deriving its funding from fees and charges levied on the services provided. Examples are the Securities and Futures Commission (SFC), FSA, OCC, OTS and GIC;

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<sup>142</sup> A detailed discussion of single- versus multiple-regulator regimes can be referred to a report entitled "Report on the Financial Systems in the United Kingdom and the United States of America" issued by the Legislative Council Panel on Financial Affairs and the Bills Committee on Securities and Futures Bill and Banking (Amendment) Bill 2000 in June 2001.

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- (d) operating on a self-financing basis through the earnings from its holding of government securities. The Fed, and FDIC are operating under such a mechanism; and
- (e) funding by the General Revenue Account which is approved by LegCo. The Trade and Industry Department (TID) is an example.

108.14 All of the authorities studied consider capital expenditure as part of the total expenditure. The approval mechanism for capital expenditure is, therefore, the same as that for operating/recurrent expenditure.

108.15 In this study, HKMA is the only authority which is financed by foreign exchange reserves. Most of the authorities studied are operating on a self-financing basis, which in effect puts a cap on the amount of expenditure incurred by these authorities as they have to operate within their means. OFTA, as a trading fund department, is subject further to the accountability arrangements set out in the Framework Agreement concluded with its policy bureau.

#### Remuneration package for the Chief Executive of the Hong Kong Monetary Authority

##### *Authority to determine remuneration package*

108.16 The authority to determine the remuneration packages for the chief executives of the regulatory bodies concerned comes from three different bodies:

- (a) FS in the case of HKMA and the Chief Executive of the Hong Kong Special Administrative Region in the case of SFC;
- (b) the management board or a sub-committee of the management board, as in the case of MPFA, the Bank of England, FSA and MAS; and
- (c) pegged to a certain level in the Executive Schedule approved by Congress, as in the case of the Fed, OCC, OTS and FDIC.

108.17 Among these three approaches, approaches (b) and (c) are more common. For approach (b), the remuneration of the head of a regulatory authority is determined by board members. However, there are concerns over conflict of interests, as some of the board members may come from the industry which is regulated by the regulatory authority.

108.18 Approach (c) may address the concerns in approach (b), since the legislature enjoys a high degree of both transparency and public participation, which should help avoid conflict of interests. This is particularly important for those authorities financed by fees and charges levied on their services, as higher salary costs would inevitably be borne by the market participants concerned.

#### *Disclosure of remuneration information*

108.19 In the UK, detailed information of the Bank and FSA on remuneration policies, including salary structure and levels, are available from their annual reports. In the US, the remuneration policies are set out in federal statute. HKMA, SFC, MPFA, MAS and GIC do not provide published information on their remuneration policies to the public.

#### Efficiency of the Exchange Fund Advisory Committee in discharging its functions

##### *Roles of the Exchange Fund Advisory Committee*

108.20 EFAC advises FS on the use of EF, and plans for the operations of HKMA, the expenditure of which is charged to EF. HKMA performs two major functions -- managing Hong Kong's foreign exchange reserves and regulating the banking sector. According to HKMA, EFAC plays no role in the direct regulation or supervision of banks, and only banking policy issues with implications on EF or affecting HKMA's objectives are referred to EFAC for advice. However, such involvement of EFAC relating to the regulation of the banking is not prescribed in BO.

#### Accountability arrangements

##### *Appointment of the Chief Executive of the Hong Kong Monetary Authority*

108.21 The Chief Executive of HKMA is appointed by FS. No information is available in the public domain on the selection criteria of such appointment. Different arrangements are adopted by different financial authorities. In the UK, there is a growing trend to adopt the Nolan Principles in selecting suitable candidates for appointment to boards of regulatory bodies (see Appendix VIII for details). In the US, the chief executives of the financial authorities studied are appointed by the US President and confirmed by the Senate.

*Reporting requirements*

108.22 Most overseas financial regulatory authorities, with the exception of GIC, are required by law to submit annual reports and financial statements to their respective legislatures. While there is no such a legal requirement, HKMA does so at its own discretion.

108.23 In the UK and the US, the accountability arrangements between the financial authorities and the legislatures are more comprehensive than those between HKMA and LegCo. For example, in the UK, the Bank's annual report is a subject of annual debate in the House of Commons. FSA is required to lay the report on the fulfilment of its objectives before the legislature. In the US, OCC and OTS are required by law to conduct an annual self-evaluation of their internal management controls based on the performance criteria prescribed by the General Accounting Office, the investigative arm of Congress. The results of the self-evaluation will be presented to Congress.

Impact of the accountability system for Principal Officials on the governance of the local authorities

108.24 The accountability system for Principal Officials was introduced in July 2002. Both HKMA and MPFA do not expect the accountability system to affect their operations. SFC, OFTA and TID have not made any assessment on the system so far. According to HKMA, the powers and functions of MA have been set out clearly in EFO and BO. MA will continue to discharge his duties in accordance with these two pieces of legislation.

108.25 The study of the overseas financial regulatory authorities, particularly those in the UK and US, has provided references of accountability arrangements. The aspects below are some of the examples:

- (a) setting out the powers and functions clearly in legislation;
- (b) appointment of the chief executive and board members through established procedures, either based on certain principles or by the legislature;
- (c) disclosure of remuneration policies;
- (d) enacting legislation to prescribe a set of comprehensive accountability arrangements between the legislature and the authority concerned; and
- (e) setting up a mechanism specifically for handling the complaints against the authority concerned.

Others

*Status of the Hong Kong Monetary Authority*

108.26 Since the expenses of HKMA are charged to EF which is a discrete fund under the control of FS, HKMA has its own rules, regulations and procedures, such as procurement rules and regulations. As such, HKMA is exempted from many rules, regulations and procedures commonly applicable to a government bureau/department.<sup>143</sup>

108.27 However, in practice, HKMA has established its role in many ways similar to that of a government bureau/department. For the study of HKMA's governance, the Research and Library Services Division (RLSD) has thus requested HKMA to clarify whether or not it is a government department. In its replies to RLSD, HKMA reiterated its long-held stance that it was an integral part of the Government. As described in paragraph 12.10, the issue of whether HKMA is a government department was raised during the discussion of the acquisition of office premises by HKMA in 2001.

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<sup>143</sup> Nevertheless, HKMA is an integral part of the Government. All employees of HKMA are public officers within the meaning of Cap. 1. All government rules, regulations or procedures that are applicable to public officers will be applicable to the staff of HKMA. For example, all HKMA staff, irrespective of their terms of appointment, are subject to the provisions of the Acceptance of Advantages (Chief Executive's) Notice 1992.

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**Table - An overall comparison of the governance of the Hong Kong Monetary Authority with comparable authorities in Hong Kong and overseas jurisdictions**

	Hong Kong						United Kingdom		United States of America				Singapore	
	Hong Kong Monetary Authority	Securities and Futures Commission	Mandatory Provident Fund Schemes Authority	Office of the Telecommunications Authority	Trade and Industry Department	Former Housing Department <sup>(1)</sup>	Bank of England	Financial Services Authority	Federal Reserve System	Office of the Comptroller of the Currency	Office of Thrift Supervision	Federal Deposit Insurance Corporation	Monetary Authority of Singapore	Government of Singapore Investment Corporation
<b>Legal framework</b>														
Whether established as a statutory body	No, headed by the Monetary Authority	Yes	Yes	No	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<b>Organizational structure</b>														
Whether governed by a management board	Yes, the Exchange Fund Advisory Committee <sup>(2)</sup>	Yes, the Board of Directors	Yes, the Management Board	No	No	No	Yes, the Court of Directors	Yes, the Board of Directors	Yes, the Board of Governors	No	No	Yes, the Board of Directors	Yes, the Board of Directors	Yes, the Board of Directors
Authority for appointing board members	Financial Secretary (FS)	CE of HKSAR appoints SFC Chairman & Deputy Chairman, while FS appoints the remaining nine members	CE of HKSAR	Not applicable	Not applicable	Not applicable	HM Treasury Open recruitment is required	HM Treasury Open recruitment is required	US President with the consent of the Senate	Not applicable	Not applicable	US President appoints non ex officio members with the consent of the Senate	President of Singapore upon the recommendation of the Cabinet	President of Singapore with the advice of the Council of Presidential Advisers (CPA)

**Table - An overall comparison of the governance of the Hong Kong Monetary Authority with comparable authorities in Hong Kong and overseas jurisdictions (cont'd)**

	Hong Kong						United Kingdom		United States of America				Singapore	
	Hong Kong Monetary Authority	Securities and Futures Commission	Mandatory Provident Fund Schemes Authority	Office of the Telecommunications Authority	Trade and Industry Department	Former Housing Department	Bank of England	Financial Services Authority	Federal Reserve System	Office of the Comptroller of the Currency	Office of Thrift Supervision	Federal Deposit Insurance Corporation	Monetary Authority of Singapore	Government of Singapore Investment Corporation
<b>Organizational structure (cont'd)</b>														
Statutory requirement(s) for board membership	Nil	Yes Majority will be Non-executive Directors after implementation of Securities and Futures Ordinance	Yes Majority must be Non-executive Directors	Not applicable	Not applicable	Not applicable	Yes Majority must be Non-executive Directors	Yes Majority must be Non-executive Directors	Yes Members representing different interests and from different Federal Reserve Districts	Not applicable	Not applicable	Yes No more than three out of the five members are of the same political party	Yes Directors cannot come from the companies it regulates	Nil
Rules of removing board members	Nil	Yes	Yes	Not applicable	Not applicable	Not applicable	Yes	Nil	Yes	Not applicable	Not applicable	Nil	Yes	Not applicable
Authority for appointing head of the authority	FS	CE of HKSAR	CE of HKSAR	Not applicable	Not applicable	Not applicable	HM Treasury	HM Treasury	US President with the consent of the Senate	US President with the consent of the Senate	US President with the consent of the Senate	US President with the consent of the Senate	President of Singapore upon the recommendation of the Cabinet	President of Singapore with the advice of CPA

**Table - An overall comparison of the governance of the Hong Kong Monetary Authority with comparable authorities in Hong Kong and overseas jurisdictions (cont'd)**

	Hong Kong						United Kingdom		United States of America				Singapore	
	Hong Kong Monetary Authority	Securities and Futures Commission	Mandatory Provident Fund Schemes Authority	Office of the Telecommunications Authority	Trade and Industry Department	Former Housing Department	Bank of England	Financial Services Authority	Federal Reserve System	Office of the Comptroller of the Currency	Office of Thrift Supervision	Federal Deposit Insurance Corporation	Monetary Authority of Singapore	Government of Singapore Investment Corporation
<b>Funding mechanism</b>														
Major source(s) of funding	Exchange Fund	Transaction levies and service fees	Investment returns from capital grant <sup>(3)</sup> Fees and charges	Licence fees	General Revenue Account	Funded by the Housing Authority	Its own capital and reserves Incomes from cash ratio deposits <sup>(4)</sup>	Fees charged on financial firms	Investment returns from government securities	Fees charged on national banks	Fees charged on thrift institutions	Investment returns from government securities	Its own capital and reserves	Management fees received from the Singapore government
<b>Mechanism for approving and controlling expenditure</b>														
Authority for approving the budget	FS	FS	FS	Secretary for Commerce, Industry and Technology	Legislative Council	Not applicable <sup>(5)</sup>	The Court of Directors	The Board of Directors	The Board of Governors	Comptroller of OCC	Director of OTS	The Board of Directors	President of Singapore	President of Singapore

**Table - An overall comparison of the governance of the Hong Kong Monetary Authority with comparable authorities in Hong Kong and overseas jurisdictions (cont'd)**

	Hong Kong						United Kingdom		United States of America				Singapore	
	Hong Kong Monetary Authority	Securities and Futures Commission	Mandatory Provident Fund Schemes Authority	Office of the Telecommunications Authority	Trade and Industry Department	Former Housing Department	Bank of England	Financial Services Authority	Federal Reserve System	Office of the Comptroller of the Currency	Office of Thrift Supervision	Federal Deposit Insurance Corporation	Monetary Authority of Singapore	Government of Singapore Investment Corporation
<b>Remuneration package for head of the authority</b>														
Authority for adjusting remuneration package	FS upon the advice of the Exchange Fund Advisory Committee	CE of HKSAR	The Board of Directors	Not applicable <sup>(6)</sup>	Not applicable <sup>(6)</sup>	Not applicable <sup>(6)</sup>	The Court of Directors	The Remuneration Committee under the Board	Congress	Congress	Congress	Congress	The Board of Directors	Not available
Publicly available information on remuneration policy	No	No	No	Yes <sup>(6)</sup>	Yes <sup>(6)</sup>	Yes <sup>(6)</sup>	Yes From its annual report	Yes From its annual report	Yes From federal statute	Yes From federal statute	Yes From federal statute	Yes From federal statute	No	No
Remuneration package	Chief Executive: HK\$9 - HK\$9.5 million	Chairman: HK\$6.5 - HK\$7 million	Managing Director: about HK\$5 million	Not applicable <sup>(6)</sup>	Not applicable <sup>(6)</sup>	Not applicable <sup>(6)</sup>	Governor: about HK\$2.8 million	Chairman: about HK\$4.3 million	Chairman: HK\$1.3 million	Comptroller: HK\$1.1 million	Director: HK\$1.1 million	Chairman: HK\$1.1 million	Not available	Not available



**Table - An overall comparison of the governance of the Hong Kong Monetary Authority with comparable authorities in Hong Kong and overseas jurisdictions (cont'd)**

	Hong Kong						United Kingdom		United States of America				Singapore	
	Hong Kong Monetary Authority	Securities and Futures Commission	Mandatory Provident Fund Schemes Authority	Office of the Telecommunications Authority	Trade and Industry Department	Former Housing Department	Bank of England	Financial Services Authority	Federal Reserve System	Office of the Comptroller of the Currency	Office of Thrift Supervision	Federal Deposit Insurance Corporation	Monetary Authority of Singapore	Government of Singapore Investment Corporation
<b>Major accountability arrangements</b>														
Appointing board members and/or head of the authority by the Administration	A p p l i e d t o a l l													
Submitting annual reports/financial statements to the Administration	Yes	Yes	Yes	Yes	Not applicable <sup>(7)</sup>	Not applicable <sup>(7)</sup>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Submitting reports on its operations/internal management controls to the Administration	Yes	Yes	Yes	Yes	Not applicable <sup>(7)</sup>	Not applicable <sup>(7)</sup>	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Whether the Administration's approval is required for its budget	Yes	Yes	Yes	Yes	No, by the Legislative Council	Not applicable <sup>(5)</sup>	No, by the Court of Directors	No, by the Board of Directors	No, by the Board of Governors	No, by the Comptroller	No, by the Director	No, by the Board of Directors	Yes	Yes

**Table - An overall comparison of the governance of the Hong Kong Monetary Authority with comparable authorities in Hong Kong and overseas jurisdictions (cont'd)**

	Hong Kong						United Kingdom		United States of America				Singapore	
	Hong Kong Monetary Authority	Securities and Futures Commission	Mandatory Provident Fund Schemes Authority	Office of the Telecommunications Authority	Trade and Industry Department	Former Housing Department	Bank of England	Financial Services Authority	Federal Reserve System	Office of the Comptroller of the Currency	Office of Thrift Supervision	Federal Deposit Insurance Corporation	Monetary Authority of Singapore	Government of Singapore Investment Corporation
<b>Major accountability arrangements (cont'd)</b>														
Whether subject to scrutiny by legislature	A p p l i e d t o a l l													
Submitting annual reports/ financial statements to legislature	Yes	Yes	Yes	Yes	Not applicable	Not applicable	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Not available
Confirming appointment of board members and/or head of the authority by legislature	No	No	No	No	No	No	No	No	Yes	Yes	Yes	Yes	No	No
Approving the salary of head of the authority by legislature	No	No	No	No	No	No	No	No	Yes	Yes	Yes	Yes	No	No

**Table - An overall comparison of the governance of the Hong Kong Monetary Authority with comparable authorities in Hong Kong and overseas jurisdictions (cont'd)**

	Hong Kong						United Kingdom		United States of America				Singapore	
	Hong Kong Monetary Authority	Securities and Futures Commission	Mandatory Provident Fund Schemes Authority	Office of the Telecommunications Authority	Trade and Industry Department	Former Housing Department	Bank of England	Financial Services Authority	Federal Reserve System	Office of the Comptroller of the Currency	Office of Thrift Supervision	Federal Deposit Insurance Corporation	Monetary Authority of Singapore	Government of Singapore Investment Corporation
<b>Major accountability arrangements (cont'd)</b>														
Providing information through its website	A p p l i e d t o a l l													
Conducting public education and publicity programmes	A p p l i e d t o a l l													
Providing a complaints handling mechanism	No	No	No	No	No	No	No	Yes A Complaints Commissioner within the Authority	No	Yes Office of Ombudsman within the Authority	No	Yes Office of Ombudsman within the Authority	No	No
<b>Operational independence</b>														
Specific legal provisions on operational independence	Nil	Nil	Nil	Nil	Nil	Nil	Yes Independence in setting interest rates	Nil	Nil	Yes	Yes	Nil	Nil	Not available

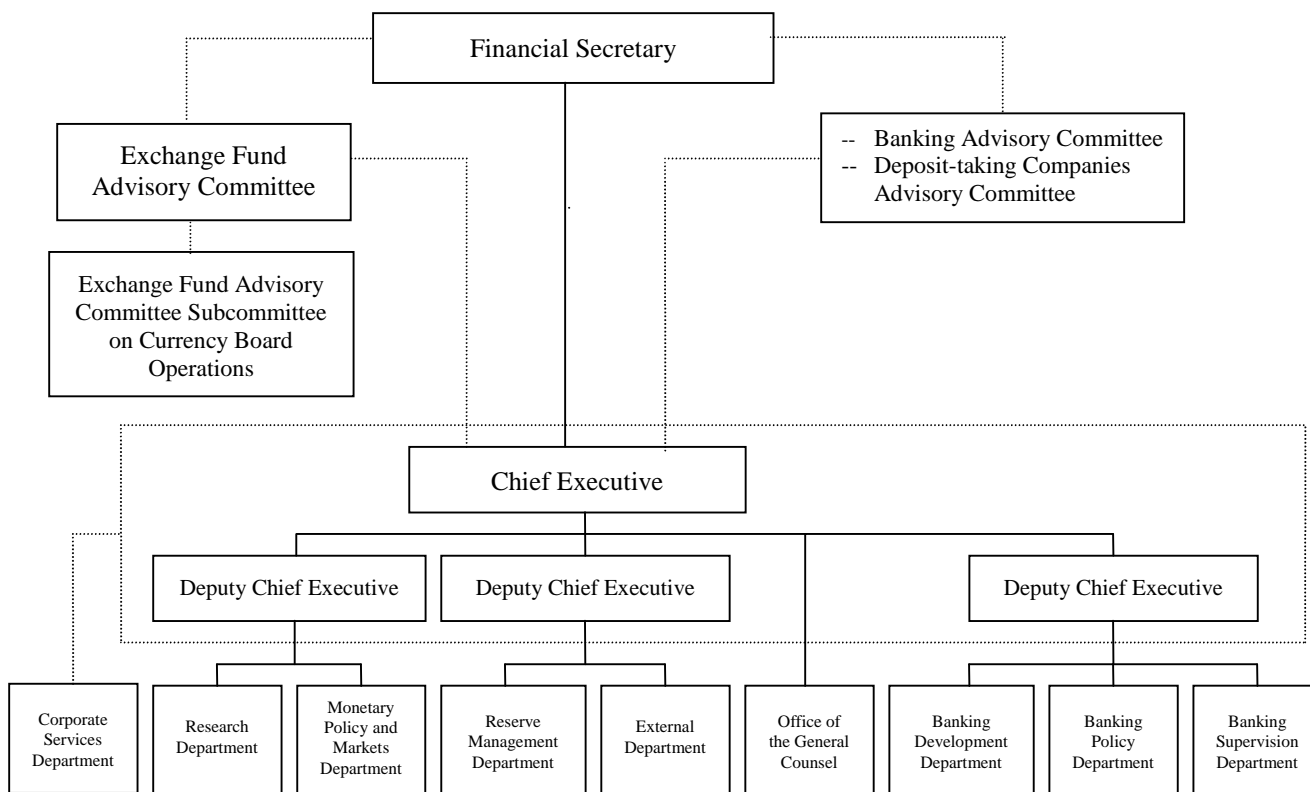
**Table - An overall comparison of the governance of the Hong Kong Monetary Authority with comparable authorities in Hong Kong**

	Hong Kong					
	Hong Kong Monetary Authority	Securities and Futures Commission	Mandatory Provident Fund Schemes Authority	Office of the Telecommunications Authority	Trade and Industry Department	Former Housing Department
<b>Impact of the accountability system for Principal Officials</b>						
Assessment made by the authority concerned	Does not expect the accountability system to affect its operations	So far it has not made any assessment	Does not foresee any major impact of the accountability system on its governance	So far it has not made any assessment	So far it has not made any assessment	Not applicable

- Notes: (1) On 1 July 2002, the Housing Department (HD) was merged with the Housing Bureau to form a new housing organization, which retains the name of the "Housing Department". The new Housing Department comes under the direction of the Secretary for Housing, Planning and Lands. The Housing Department that existed before 1 July 2002 is addressed as the "Former Housing Department" in this study.
- (2) The Exchange Fund Advisory Committee functions as the de facto management board responsible for overseeing the operations of the Hong Kong Monetary Authority. In addition, the Committee advises the Financial Secretary, the controller of Exchange Fund, on general policy relating to the deployment of the Exchange Fund.
- (3) The Mandatory Provident Fund Schemes Authority (MPFA) received a capital grant of HK\$5 billion from the Legislative Council in April 1998 for financing the establishment and operating costs of MPFA. Since then, it has not requested any funding support from the Administration.
- (4) All commercial banks and building societies operating in the United Kingdom are required to maintain non-interest bearing deposits with the Bank of England.
- (5) HD did not prepare its own budget. Instead, the Housing Authority (HA) budgeted for the expenses incurred by HD in preparing its functions as the executive arm of the HA.
- (6) The remuneration package is in conformity with the civil service pay policy, system and structure.
- (7) The Trade and Industry Department reports to its policy bureau, while the former HD reported to HA.

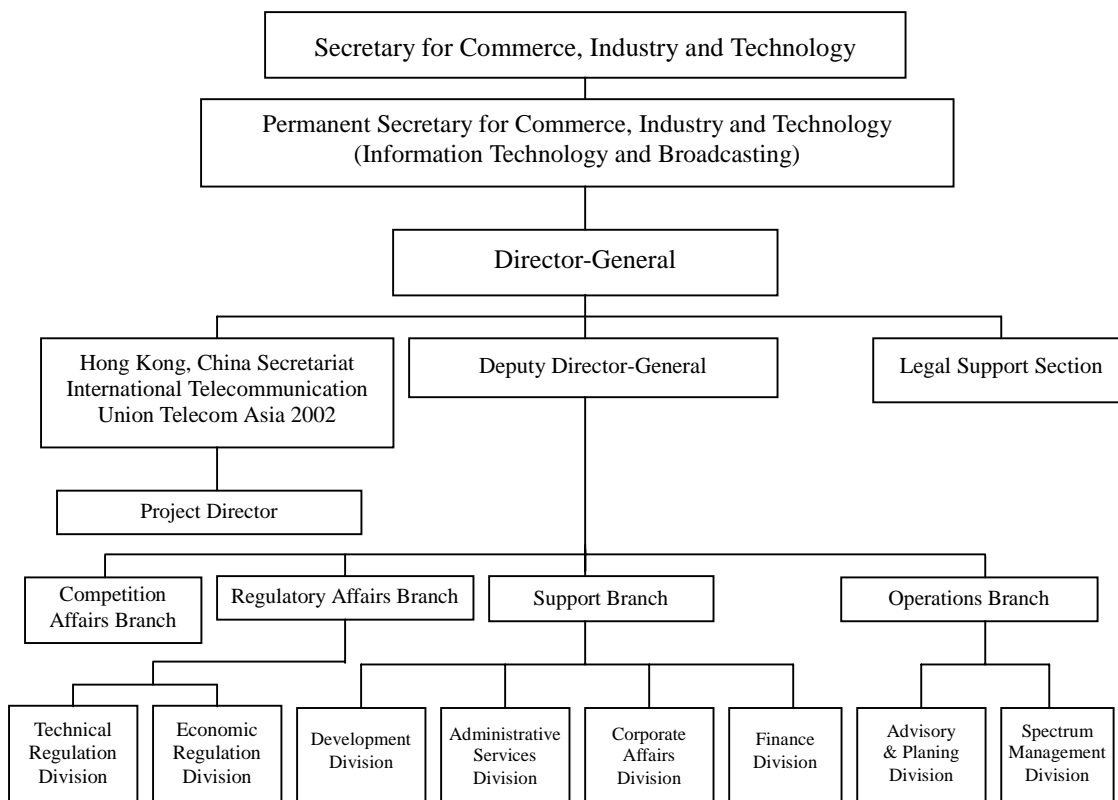
**Appendix I**

**Organizational structure of the Hong Kong Monetary Authority**



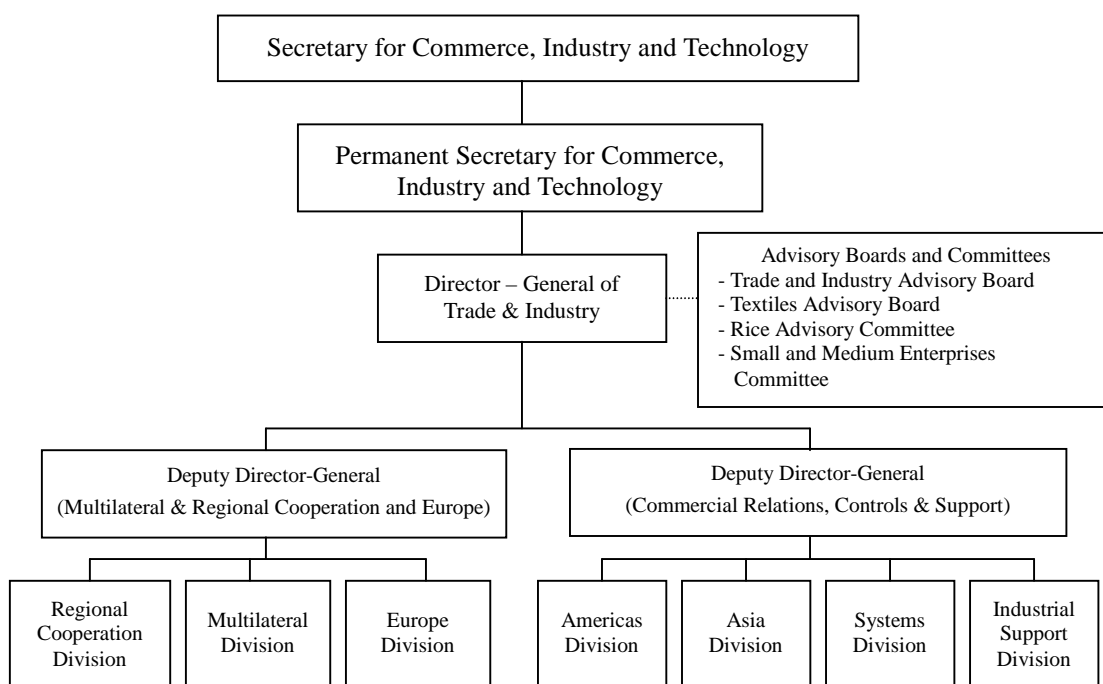
Appendix II

Organizational structure of the Office of the Telecommunications Authority



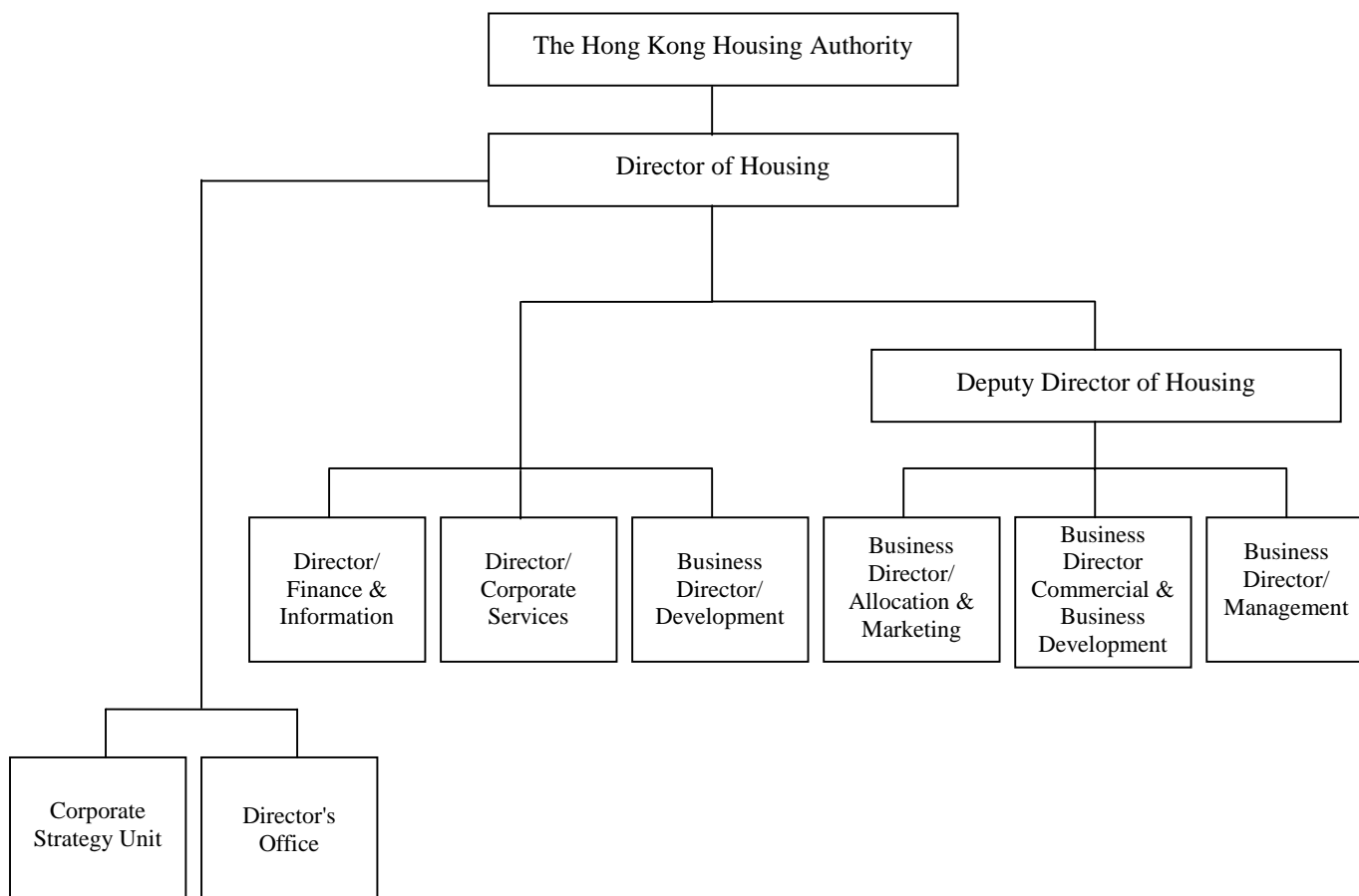
### Appendix III

#### Organizational structure of the Trade and Industry Department



## Appendix IV

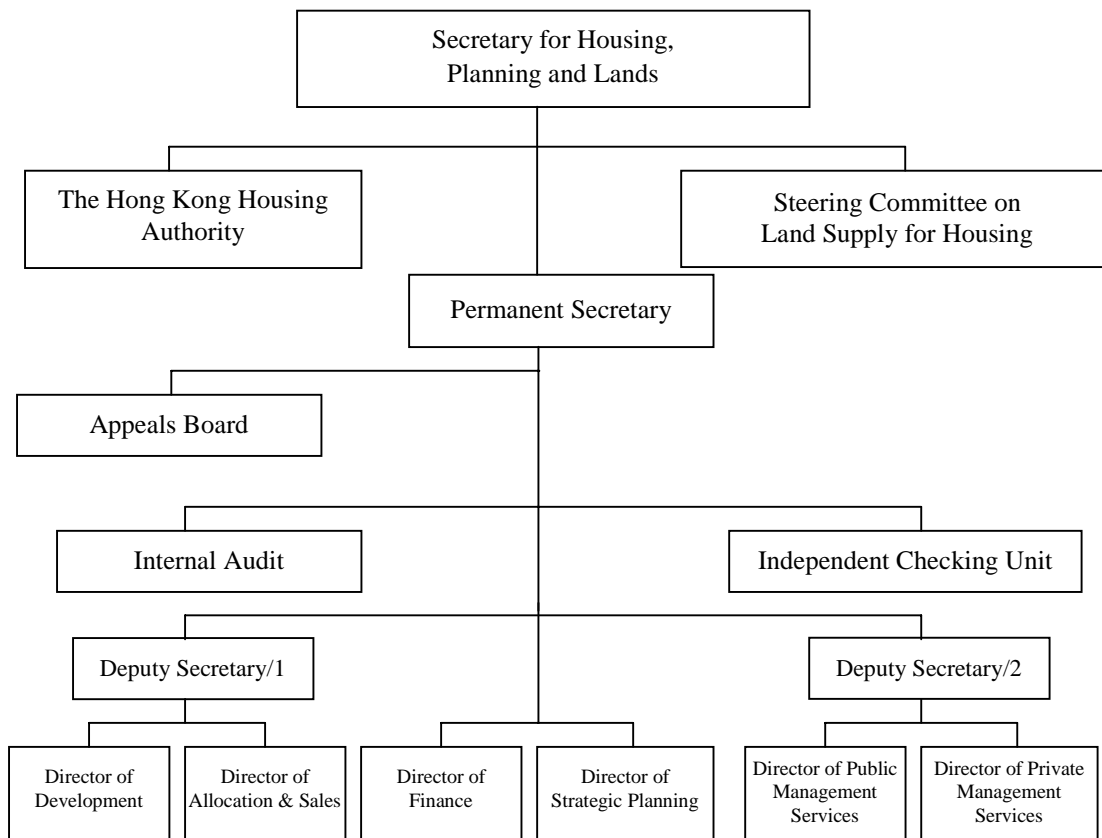
### Organizational structure of the former Housing Department





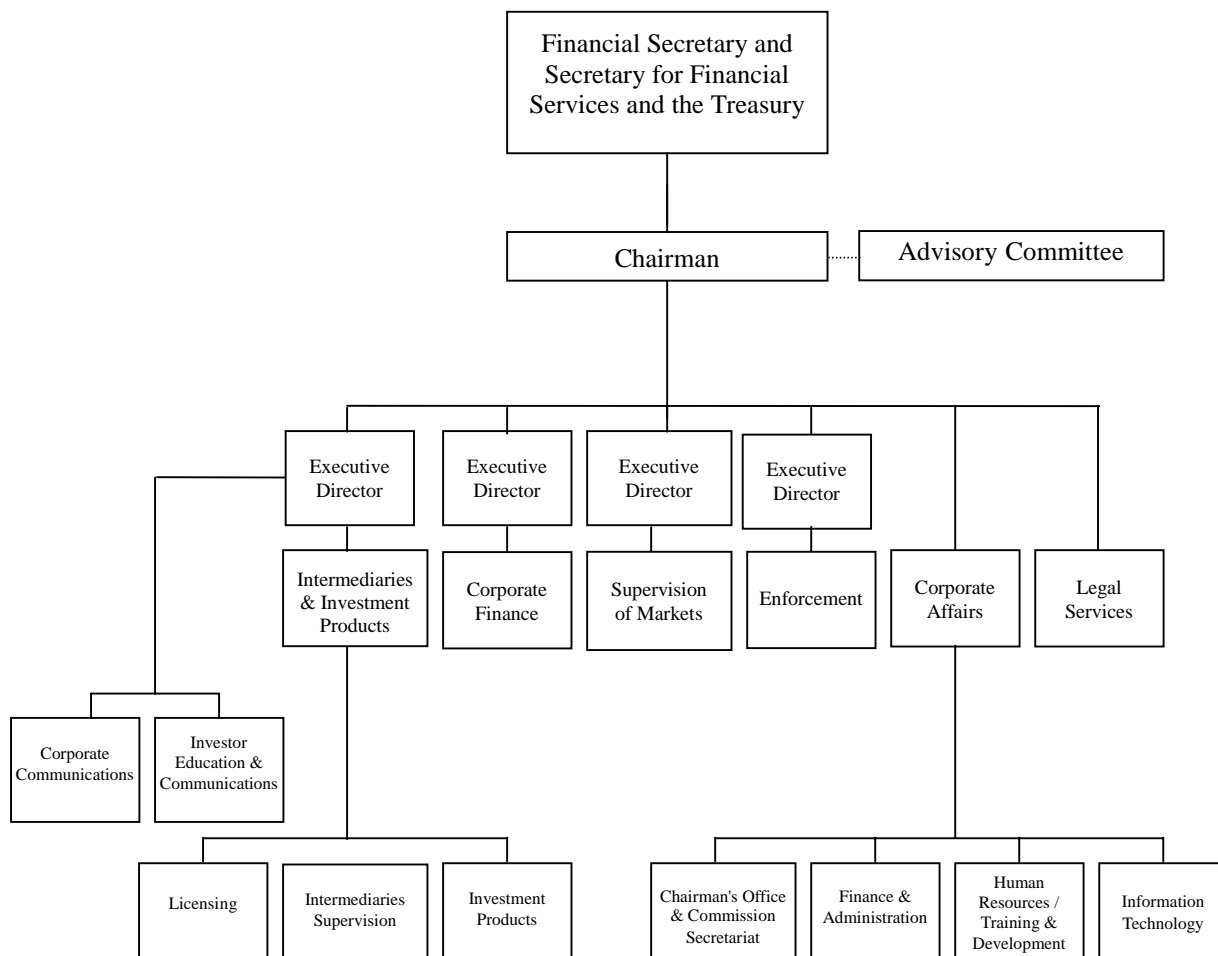
**Appendix V**

**Proposed framework for the new housing organization**



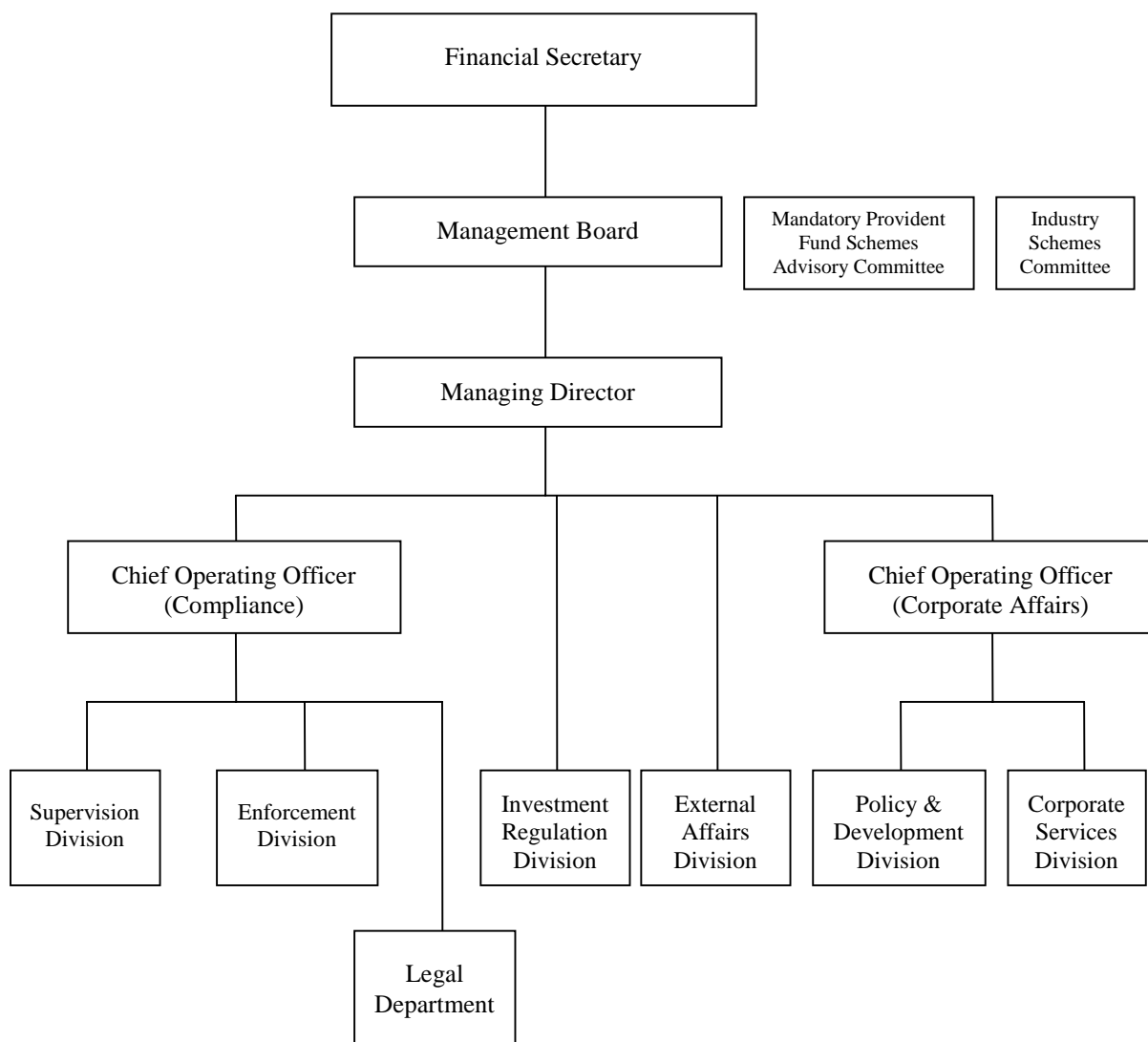
Appendix VI

Organizational structure of the Securities and Futures Commission



**Appendix VII**

**Organizational structure of the  
Mandatory Provident Fund Schemes Authority**



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## Appendix VIII

### The Seven Principles of Public Life (known as the Nolan Principles)

A.1 In October 1994, the former Prime Minister, John Major, invited Lord Nolan to become the first Chairman of the Committee on Standards in Public Life. The Committee's terms of reference were to examine the standards of conduct of all holders of public office, including arrangements relating to financial and commercial activities, and make recommendations as to any changes in the arrangements which might be required to ensure the highest standards of propriety in public life.

A.2 The Committee has published seven reports, which contain 308 recommendations. In the First Report entitled *Standards in Public Life* published in 1995, the Committee drew up the Seven Principles of Public Life (known as the Nolan Principles) as a re-statement of the general principles of conduct underpinning public life. Details of the Principles are provided below:

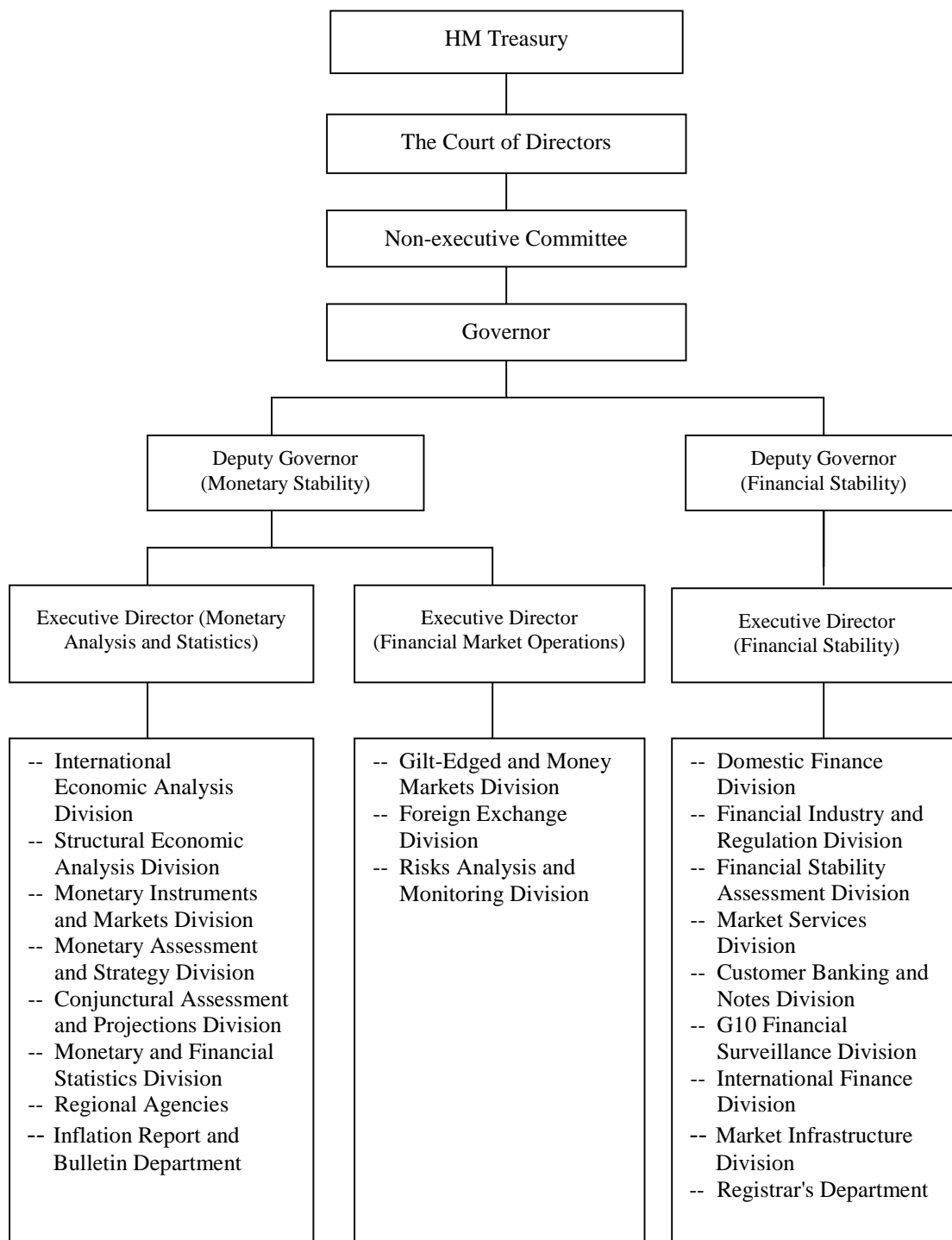
- (a) Selflessness — holders of public office should act solely in terms of the public interest. They should not do so in order to gain financial or other benefits for themselves, their family or their friends.
- (b) Integrity — holders of public office should not place themselves under any financial or other obligation to outside individual or organizations that might seek to influence them in the performance of their official duties.
- (c) Objectivity — in carrying out public business, including public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.
- (d) Accountability — holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.
- (e) Openness — holders of public office should be as open as possible about all the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands.
- (f) Honesty — holders of public office have a duty to declare any private interests relating to their public bodies and to take steps to resolve any conflicts arising in a way that protects the public interest.
- (g) Leadership — holders of public office should promote and support these principles by leadership and example.

**Appendix VIII - (cont'd)**

- A.3 The Committee also recommended that:
- (a) all public bodies should draw up their Codes of Conduct incorporating the Seven Principles; and
  - (b) internal systems for maintaining standards should be supported by independent scrutiny.

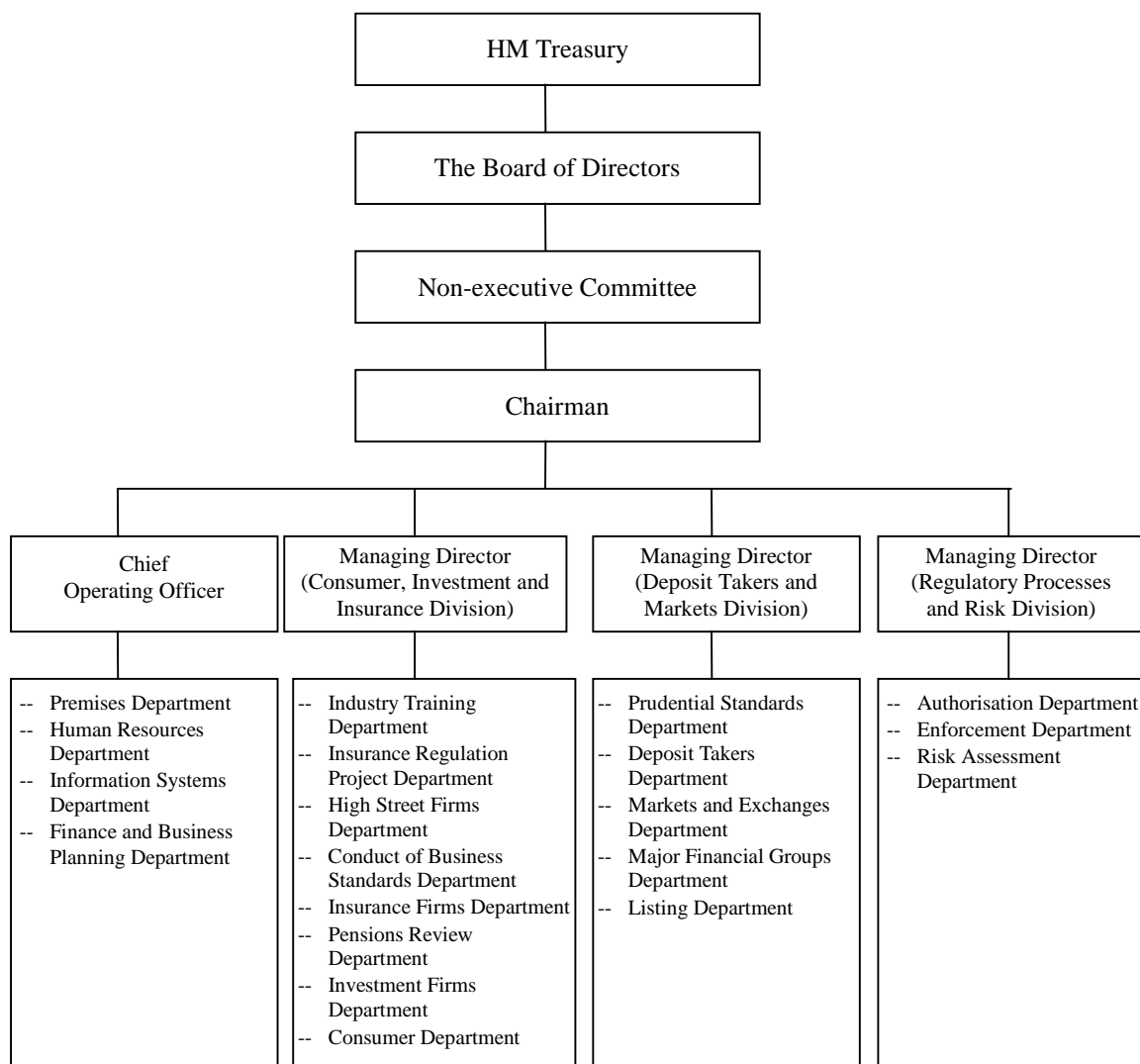
**Appendix IX**

**Organizational structure of the Bank of England**



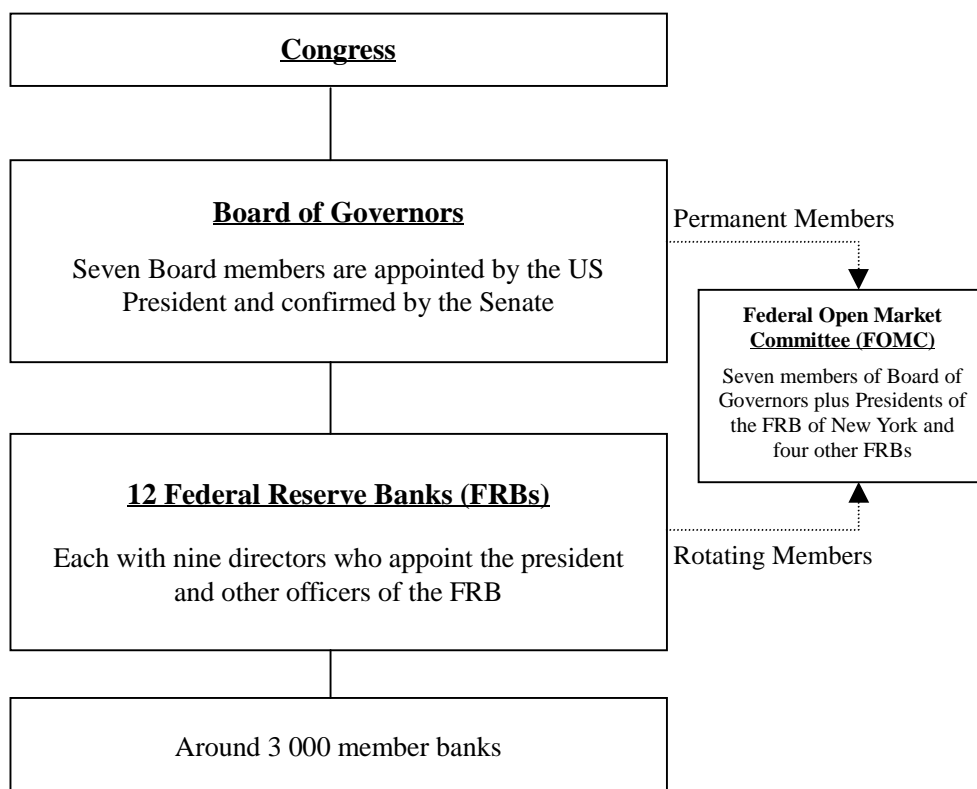
**Appendix X**

**Organizational structure of the Financial Services Authority**



## Appendix XI

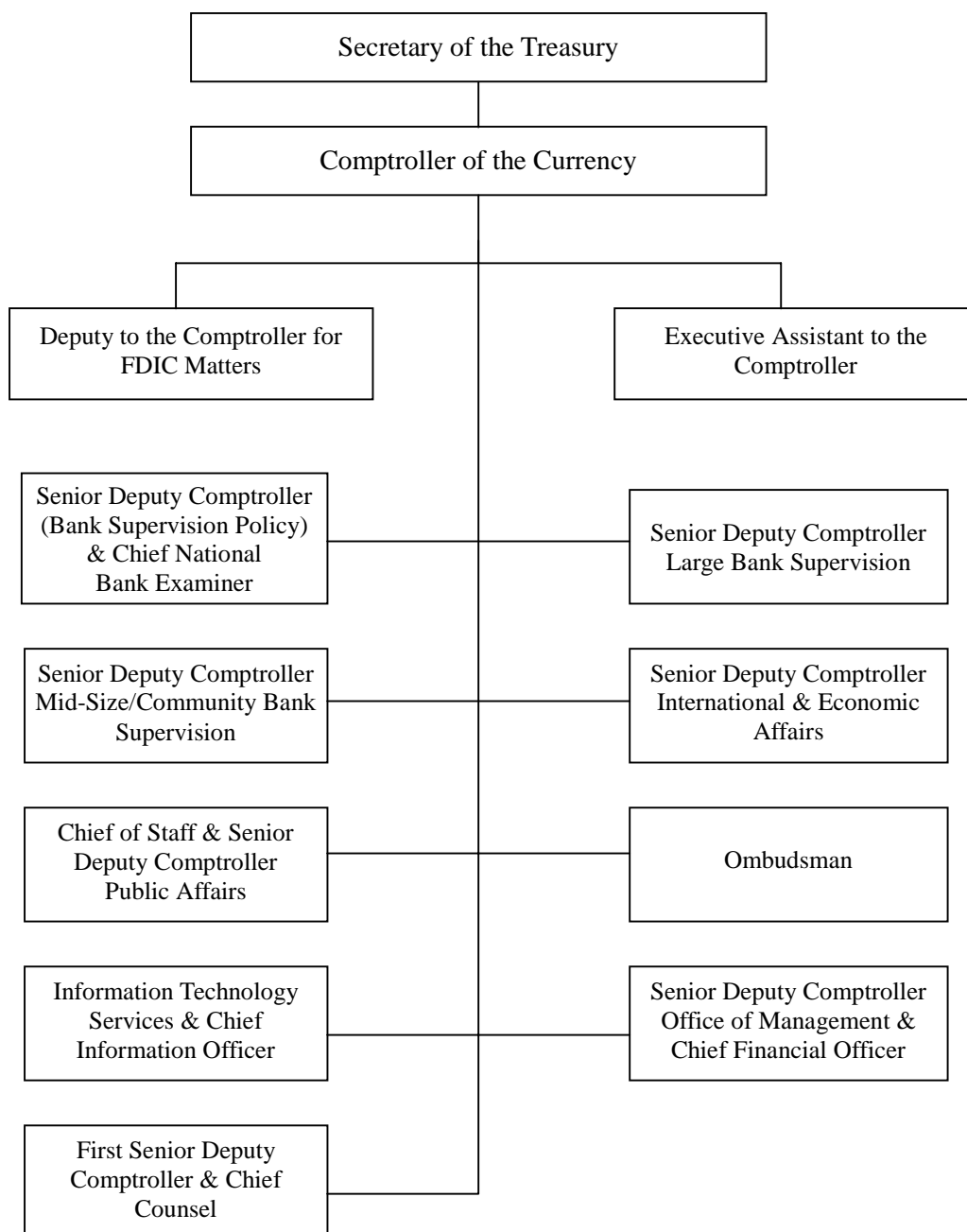
### Organizational structure of the Federal Reserve System





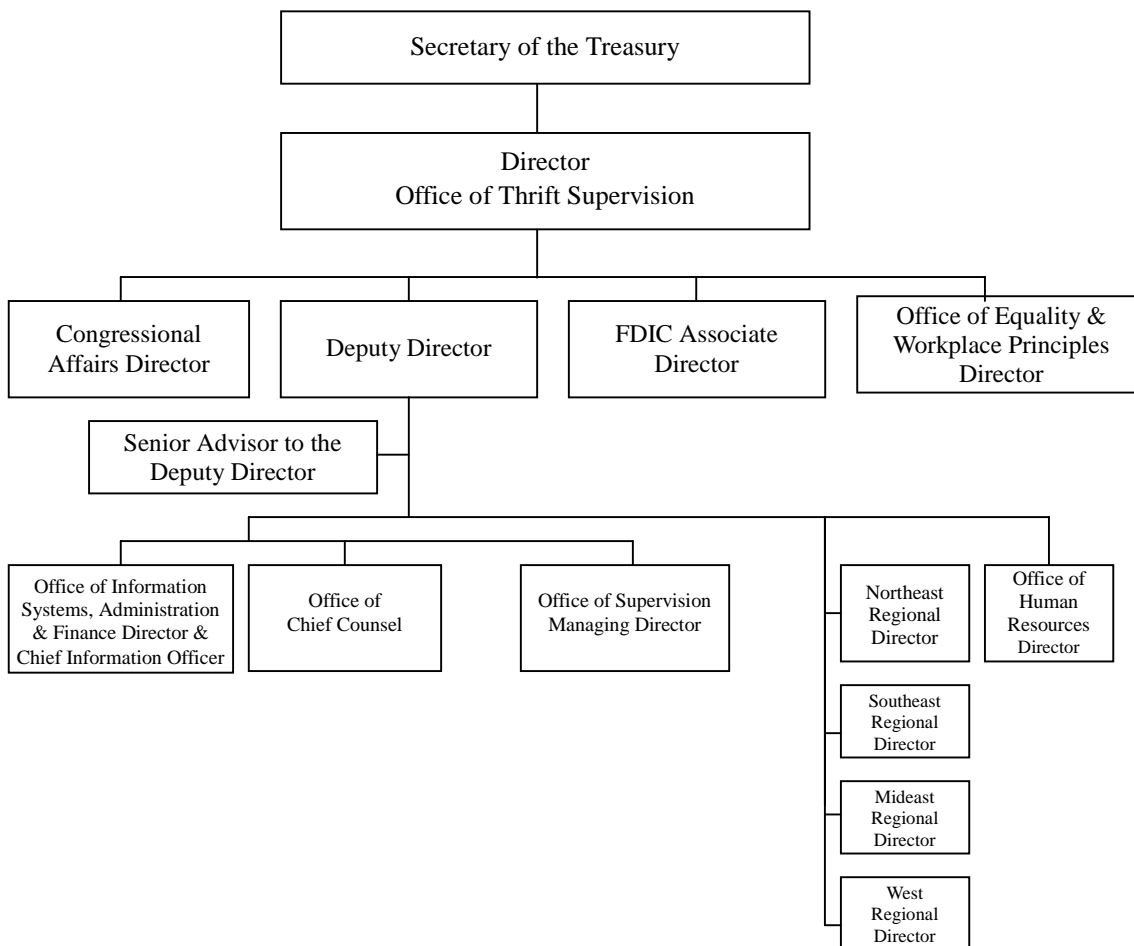
Appendix XII

Organizational structure of the Office of the Comptroller of the Currency



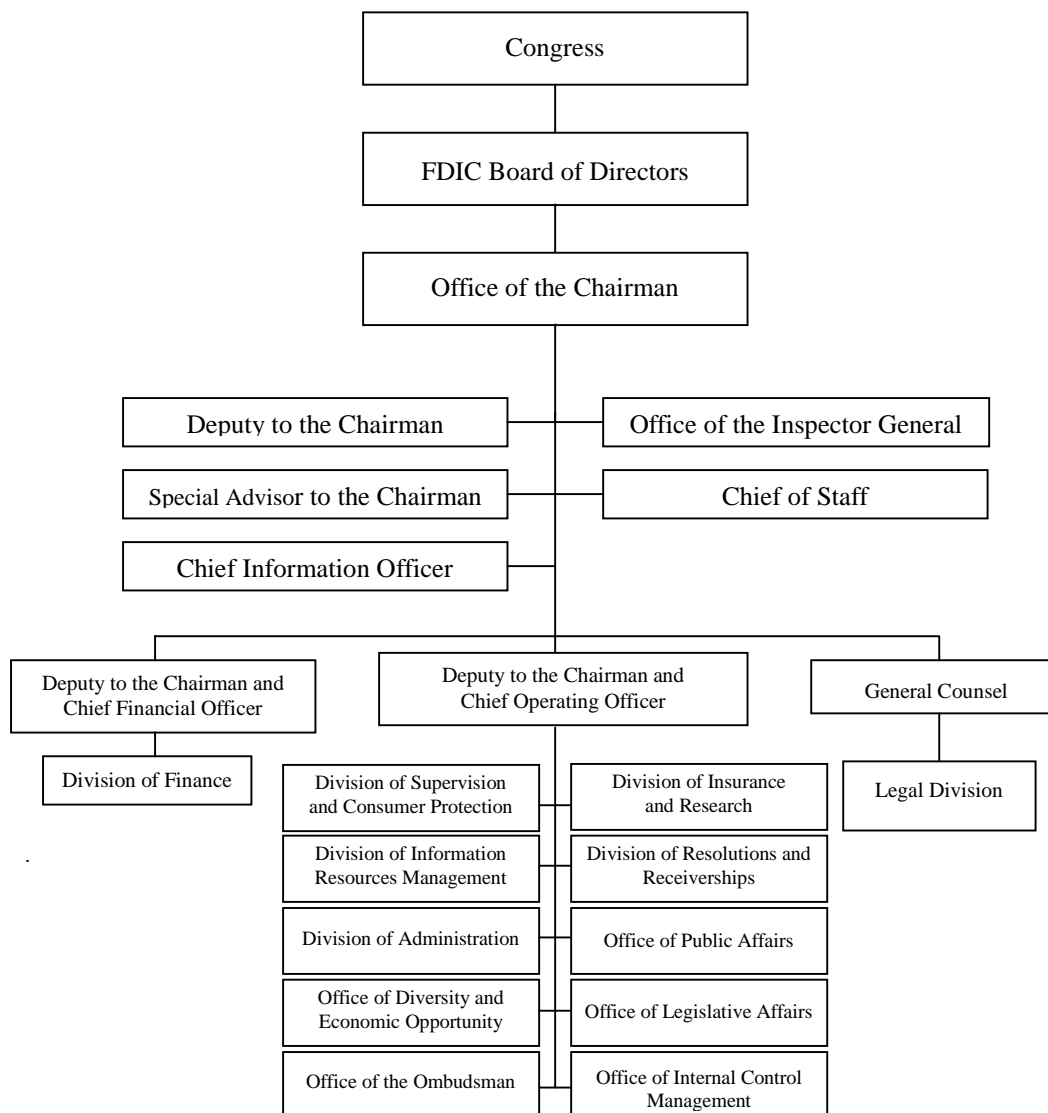
**Appendix XIII**

**Organizational structure of the Office of Thrift Supervision**



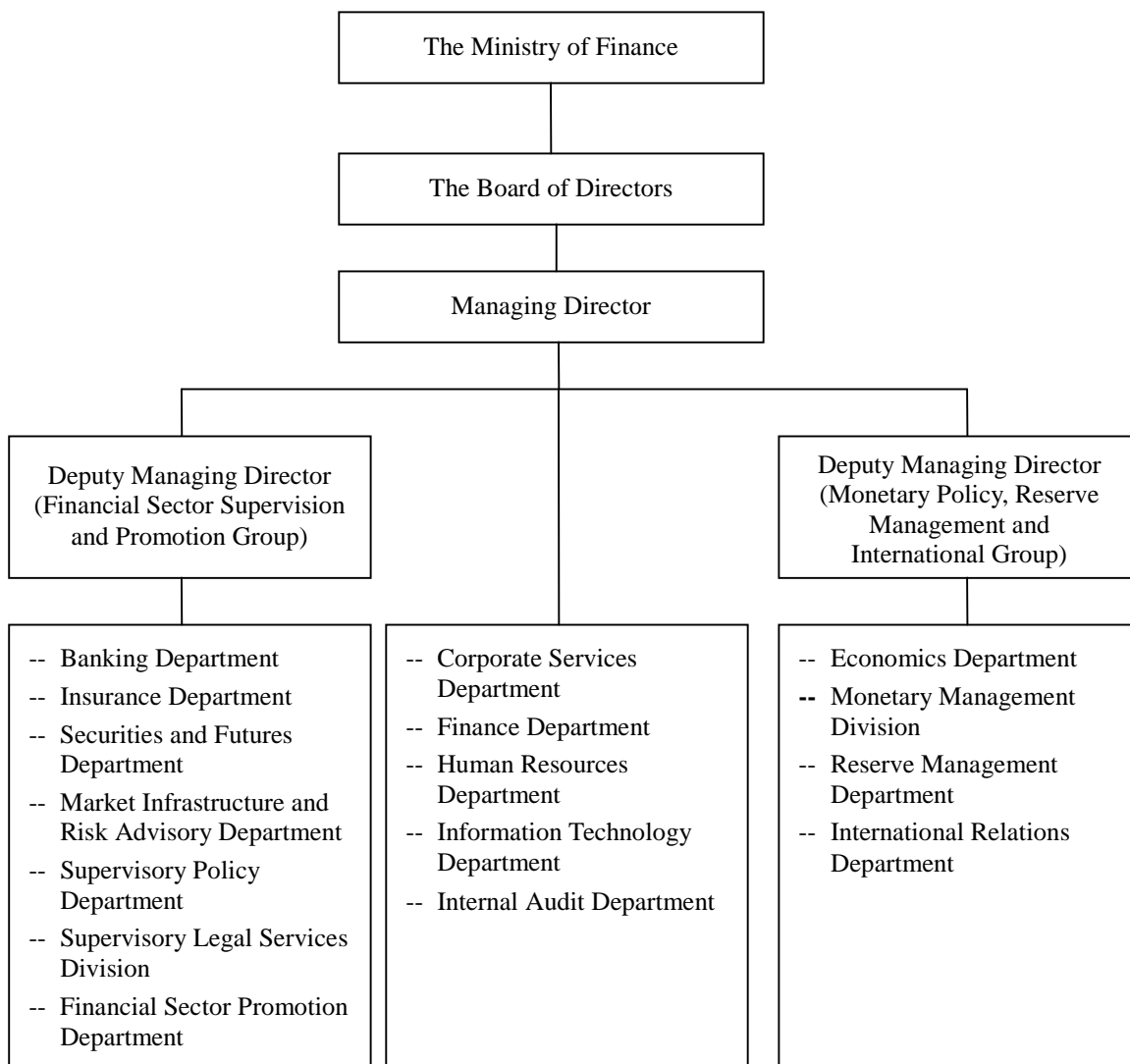
**Appendix XIV**

**Organization structure of the Federal Deposit Insurance Corporation**



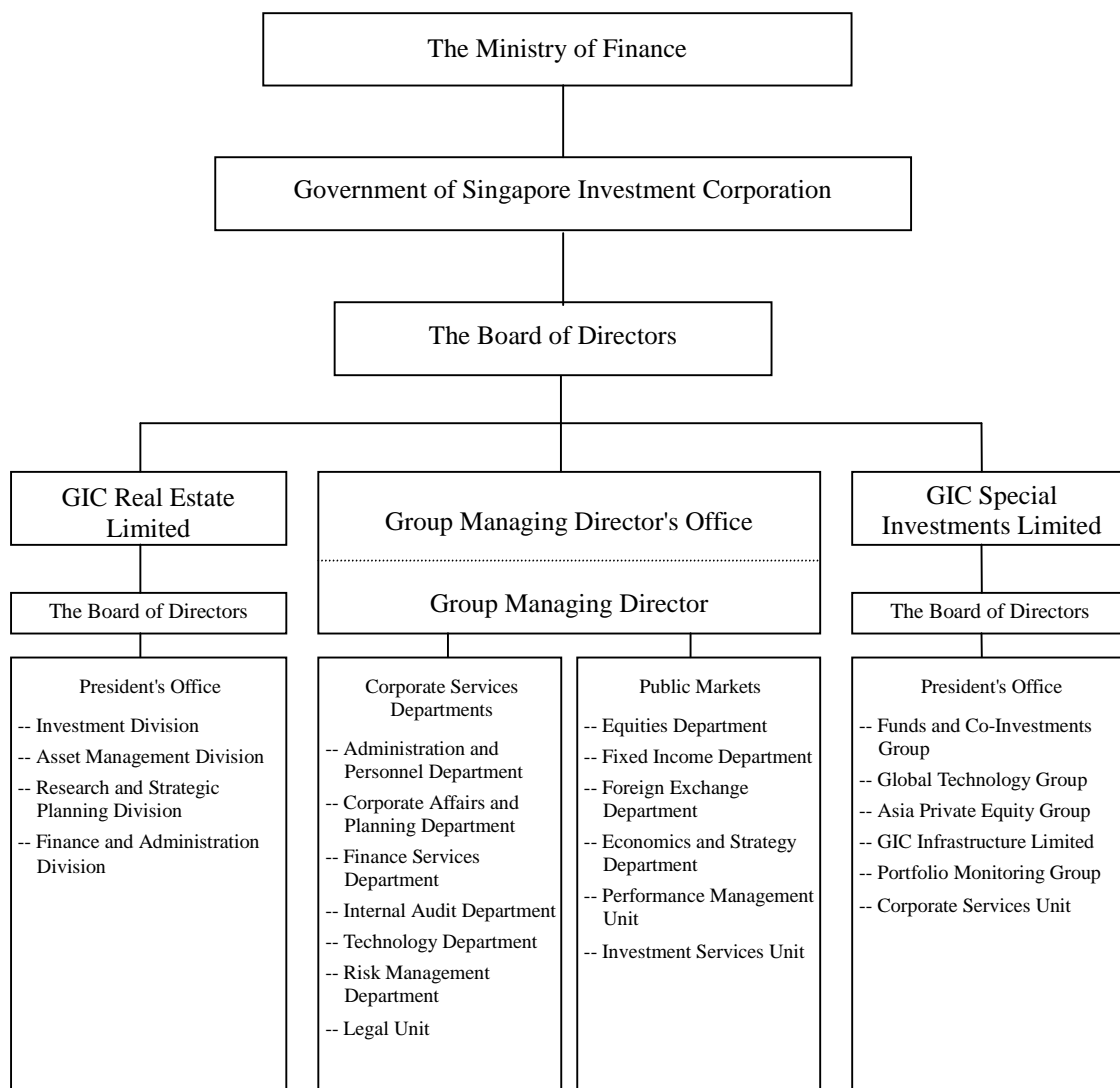
Appendix XV

Organizational structure of the Monetary Authority of Singapore



**Appendix XVI**

**Organizational structure of the Government of Singapore Investment Corporation**



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