

立法會
Legislative Council

LC Paper No. CB(1)672/03-04
(These minutes have been seen
by the Administration)

Ref : CB1/PL/FA/1

Panel on Financial Affairs

Minutes of meeting
held on Thursday, 6 November 2003 at 9:00 am
in the Chamber of the Legislative Council Building

Members present : Hon Ambrose LAU Hon-chuen, GBS, JP (Chairman)
Hon Henry WU King-cheong, BBS, JP (Deputy Chairman)
Hon Kenneth TING Woo-shou, JP
Hon James TIEN Pei-chun, GBS, JP
Hon LEE Cheuk-yan
Dr Hon Eric LI Ka-cheung, GBS, JP
Dr Hon David LI Kwok-po, GBS, JP
Hon NG Leung-sing, JP
Hon James TO Kun-sun
Hon Bernard CHAN, JP
Hon CHAN Kam-lam, JP
Hon SIN Chung-kai
Hon Jasper TSANG Yok-sing, GBS, JP
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, JP

Non-Panel Member : Hon LI Fung-ying, JP
attending

Members absent : Dr Hon David CHU Yu-lin, JP
Hon Albert HO Chun-yan
Dr Hon Philip WONG Yu-hong, GBS

**Public officers
attending**

: Agenda Item IV

Mr Benjamin TANG, JP
Commissioner of Insurance

Agenda Items IV and V

Mr Tony MILLER, JP
Permanent Secretary for Financial Services and the Treasury
(Financial Services)

Mrs Clarie LO, JP
Deputy Secretary for Financial Services and the Treasury
(Financial Services)²

Agenda Item V

Mr Frederick MA, JP
Secretary for Financial Services and the Treasury

Agenda Item VI

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

Mr William RYBACK
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Norman CHAN, SBS, JP
Deputy Chief Executive
Hong Kong Monetary Authority

Mr Raymond LI, JP
Executive Director
Hong Kong Monetary Authority

Mr Eddie YUE, JP
Executive Director
Hong Kong Monetary Authority

Attendance by invitation : Agenda Item V

Mr Andrew SHENG
Chairman
Securities and Futures Commission

Mr Ashley ALDER
Member and Executive Director
Securities and Futures Commission

Mr Paul CHOW
Chief Executive
Hong Kong Exchanges and Clearing Limited

Mr Richard WILLIAMS
Head of Listing
Hong Kong Exchanges and Clearing Limited

Clerk in attendance : Miss Salumi CHAN
Chief Assistant Secretary (1)5

Staff in attendance : Ms Pauline NG
Assistant Secretary General 1

Ms Connie SZETO
Senior Assistant Secretary (1)4

Mr Joey LO
Assistant Secretary (1)1

Ms May LEUNG
Legislative Assistant

I. Confirmation of minutes of meeting

(LC Paper No. CB(1)213/03-04 — Minutes of meeting on 9 October 2003)

The minutes of meeting held on 9 October 2003 were confirmed.

II. Information papers issued since the regular meeting held on 7 July 2003

2. Members noted the following information papers issued since the regular meeting held on 7 July 2003 -

- (a) Information Paper on “Proposal to delink the rates of honoraria for new trainees under the Valuation Surveying Graduate Training Scheme from civil service pay” (LC Paper No. CB(1)2165/02-03(01));
- (b) Official document on “Responsibilities of the Financial Secretary and the Secretary for Financial Services and the Treasury” (LC Paper No. CB(1)2194/02-03(01));
- (c) Press release on “Appointment of Mr William A. Ryback as Deputy Chief Executive of the Hong Kong Monetary Authority” provided by the Hong Kong Monetary Authority (LC Paper No. CB(1)2211/02-03);
- (d) The Securities and Futures Commission Quarterly Report for 1 April to 30 June 2003 (LC Paper No. CB(1)2355/02-03);
- (e) Mandatory Provident Fund Schemes Statistical Digest — June 2003 (LC Paper No. CB(1)2380/02-03);
- (f) Half-yearly Economic Report 2003 (LC Paper No. CB(1)2387/02-03);
- (g) Consultation Paper on the proposals to enhance the oversight of the public interest activities of auditors and to establish a Financial Reporting Review Panel (LC Paper No. CB(1)2487/02-03);
- (h) Mandatory Provident Fund Schemes Authority Annual Report 2002-03 (LC Paper No. CB(1)2507/02-03);
- (i) Consultation paper on proposals to enhance the regulation of listing (LC Paper No. CB(1)2545/02-03);
- (j) Administration’s response on review of sections 273 and 275 of the Companies Ordinance (LC Paper No. CB(1)2553/02-03);

- (k) Information note on the proposed amendments to Bankruptcy Ordinance: Outsourcing of bankruptcy cases by Official Receiver's Office to private sector insolvency practitioners (LC Paper No. CB(1)98/03-04(01)); and
- (l) Issues referred by the Finance Committee on submission on Hong Kong tax lease transactions (LC Paper Nos. CB(1)186/03-04(01) and (02)).

III. Date of next meeting and items for discussion

(LC Paper No. CB(1)212/03-04(01) — List of outstanding items for discussion

LC Paper No. CB(1)212/03-04(02) — List of follow-up actions

LC Paper No. CB(1)226/03-04(01) — Letter dated 24 October 2003 from the Clerk to Panel to the Administration on Hon James TO's proposed discussion item

LC Paper No. CB(1)226/03-04(02) — Administration's reply dated 30 October 2003 on Hon James TO's proposed discussion item)

Regular meeting for December 2003

3. Members noted that the following three discussion items were proposed for the regular meeting in December 2003:

- (a) Briefing by the Financial Secretary (FS) on Hong Kong's latest overall economic situation;
- (b) Proposed deletion and redeployment of directorate post in the Inland Revenue Department (IRD); and
- (c) Examination of the regulatory work in respect of authorized institutions in the light of the "Report of the Special Committee on the Corporate Governance, Credit Approval Process, Risk Management and Internal Control Mechanism of Bank of China (Hong Kong) Limited" (the Special Committee Report).

4. On paragraph 3(a) above, members noted that FS would brief the Panel on Hong Kong's latest overall economic situation after the release of the Third Quarter

Economic Report in late November 2003. On paragraph 3(b) above, the Administration would brief members on its proposal to delete one D1 post and to deploy one D2 post in view of IRD's business process re-engineering plans. The Administration planned to submit the proposal to the Establishment Subcommittee on 10 December 2003. As regards paragraph 3(c) above, the item was proposed by Mr James TO for the Panel to discuss with the Administration (including the Hong Kong Monetary Authority (HKMA)) on its regulatory work in respect of authorized institutions in the light of the Special Committee Report.

5. As FS and the subject officer of HKMA would be on business trips outside Hong Kong in early December 2003, members agreed that the regular meeting for December originally scheduled for 1 December be rescheduled to be held on Saturday, 6 December from 9:45 am to 12:30 pm.

6. Mr SIN Chung-kai agreed that the regular Panel meeting for December be rescheduled. However, he considered that rescheduling of regular Panel meetings should be avoided in future and suggested that special meetings be arranged if necessary. Whilst appreciating Mr SIN's views, the Chairman pointed out that at the Panel meeting on 9 October 2003, some members had expressed their views that special meetings should be arranged only under special circumstances. The Chairman assured members that he had taken account of all relevant factors in making meeting arrangements and would continue to do so in future.

(Post-meeting note: At the request of the Administration and with the concurrence of the Chairman, the item mentioned at paragraph 3(b) above was subsequently deleted from the agenda for the meeting on 6 December 2003.)

IV. Review on the institutional set-up of the Office of the Commissioner of Insurance

(LC Paper No. CB(1)212/03-04(03) — Paper provided by the Administration

LC Paper No. CB(1)1881/02-03 — Letter dated 29 May 2003 from the Commissioner of Insurance on Proposal to review the Institutional Set-up of the Office of the Commissioner of Insurance)

Briefing by the Administration

7. At the invitation of the Chairman, the Permanent Secretary for Financial Services and the Treasury (Financial Services) (PSFS) and the Commissioner of Insurance (COI) briefed members on the review of the institutional set-up of the Office of the Commissioner of Insurance (OCI). PSFS said that as pointed out by FS

in his Budget Speech delivered on 5 March 2003, the Administration was studying arrangements to turn the OCI into an agency independent of the Government and such an arrangement was in line with international regulatory trends. COI explained that pursuant to section 4 of the Insurance Companies Ordinance (Cap. 41), the Chief Executive “shall appoint a public officer to be the Insurance Authority (IA) for the purposes of this Ordinance”. The COI was appointed for this role. The principal function of the IA was to regulate and supervise the insurance industry for the promotion of the general stability of the insurance industry and for the protection of existing and potential policyholders. Unlike all other financial services regulators in Hong Kong, however, the IA, while independent in law, remained institutionally within the Government and was staffed by civil servants. This institutional arrangement was not in line with the international regulatory trend that regulators be seen to be clearly independent of the government, and deviated from Core Principle 3 of the International Association of Insurance Supervisors which provided that an insurance supervisor should be operationally independent. Moreover, the International Monetary Fund (IMF) in its Financial Sector Assessment Programme report published earlier this year commented that the insurance supervisory function in Hong Kong could not be considered truly independent as long as the OCI was part of the Government.

8. COI elaborated that separately a study conducted by the then Financial Services Bureau in 2002 concluded that the IA should become an independent regulator in the longer term. The Government had then conducted a stakeholder consultation from late May to the end of July 2003. By the end of the consultation, a total of 20 written submissions had been received. Market participants were generally cautious about the powers and governance of the future IA as well as its funding and any cost implications for the insurance industry. Respondents who were not market participants generally supported the proposal.

9. COI concluded that the study on turning the IA into an independent regulator was still on-going and the Administration welcomed any views from Members.

Discussion

Need for an independent insurance authority

10. Mr Henry WU was concerned whether there was a genuine need for turning the IA into an independent regulator. From the paper provided by the Administration, it seemed that the main reason for the proposed change was that the existing institutional arrangement was not in line with the international regulatory trend. He did not consider this reason convincing. PSFS advised that the principal argument in favour of making the IA independent of the Government was philosophic, not economic. The international trend was to make the regulators independent of their governments, both in law and in finances, in order to insulate the regulators from any possibility of political interference in the day-to-day regulation of the industry.

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11. Mr CHAN Kam-lam noted from paragraph 4 of the paper that an independent IA would be in a better position to respond to market changes. It seemed to imply that the existing IA was inflexible and could not respond to market changes. He considered that with the limited information provided in the paper, it was difficult for Members to comprehend the practical difficulties encountered under the existing institutional arrangement and the need for the IA to be independent of the Government. Mr CHAN urged the Administration to provide more detailed information when consulting the Panel again in future. PSFS advised that the paper only served as a progress report and the Administration would consult the Panel again with more detailed information after further discussions with the industry.

12. Mr NG Leung-sing supported in principle the proposal for the IA to be independent of the Government. He however did not consider what stated in paragraph 4 of the paper a good reason to justify the proposal. According to paragraph 4 of the paper, an independent regulator, not being subject to normal governmental resource allocation and personnel constraints, would enjoy greater flexibility in quickly acquiring and deploying adequate manpower and expertise in response to new priorities or regulatory challenges. Mr NG considered that the IA should ensure effective allocation of resources at all times. In reply, COI explained that under the present government structure and policy, he did not have the flexibility of offering more attractive terms of employment to facilitate recruitment and retention of staff. For example, there were only a few hundred actuaries working in Hong Kong and some of them had already left the COI to pursue their career in the Mainland. If the problem was not addressed, there might not be sufficient actuaries for the COI in future.

Overseas regulatory models

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13. Referring to paragraph 3 of the paper where it was stated that the insurance regulators in the United Kingdom (UK), Australia and Singapore were all independent of their governments, Mr Henry WU enquired whether the Administration had made reference to the practices in other countries, such as the United States (US), Canada and European countries. COI advised that in the US, there were 51 insurance regulators in its 51 states or territories. While some of them were politically appointed, some were elected. The Administration did not consider it an appropriate model to study. Mr WU considered that the Administration should study the practices in other countries, such as Canada and European countries.

14. As the insurance industry in Hong Kong had been performing well and the situation in Australia was chaotic, Mr Kenneth TING doubted whether it was appropriate to model Hong Kong's insurance regulatory structure on that of Australia. PSFS clarified that the Administration was not advocating any particular model. Australia was only mentioned in paragraph 3 of the paper as one of the countries where the insurance regulator was independent of the government.

Admin

15. Mr SIN Chung-kai indicated that he supported the independent regulator proposal in principle. He however considered that the Administration should be open-minded and conduct further studies and consultation. Noting that UK adopted an integrated-regulator model under which the Financial Services Authority was the single regulator of all financial services, including insurance, Mr SIN enquired whether the Administration had studied the merits and demerits of this model. PSFS advised that under the existing regulatory structure of Hong Kong, separate regulatory agencies were established for separate financial services sectors. He did not find the idea of having a single regulator attractive because of possible over-concentration of regulatory power in one agency. Responding to the Chairman, PSFS said that that was his personal view. He also confirmed that the Administration had not conducted a detailed analysis of the UK model. As the UK model had been in existence for only a short period of time, its effectiveness had yet to be assessed. Mr SIN said that he was not in favour of or against the UK model but considered that the Administration should study it in more detail as reference.

16. Mr Bernard CHAN said that the insurance industry had strong objection to the amalgamation of the IA with other existing financial services regulators, such as the Securities and Futures Commission (SFC). COI responded that the Administration was aware of the concern of the insurance industry and the proposed change was not heading for amalgamation.

Impact of the proposal

17. Referring to paragraph 8 of the paper, Mr Bernard CHAN highlighted the concerns of the insurance industry on the proposal for the IA to become independent of the Government, including the possible increase in operating cost and licence fees for insurers and insurance intermediaries, possible increase in powers of the future IA, etc. PSFS and COI assured members that it remained the Administration's intention that there should be no expansion in the IA's regulatory powers as a result of its becoming independent.

18. On operating cost, Mr James TO enquired whether the expenditure of the IA would be reduced after its independence. PSFS advised that it was expected that the level of expenditure would not be dissimilar from the existing one.

19. Mr Bernard CHAN considered that irrespective of whether the IA would be independent of the Government, it should study measures for cost control, such as moving its office to premises in low rent areas and controlling staff costs. Quoting the SFC which had been independent of the Government since late 1980s as an example, Mr Henry WU pointed out that independent regulators could decide on their own whether to control cost. They could choose their own office premises, expand their staff establishment, and not to follow the civil service pay reduction. Mr WU was concerned how the Legislative Council (LegCo) and the Administration could

supervise the IA after its independence. PSFS advised that on the assumption that a consensus could be reached on the way forward and it was decided that the proposal for the IA to be independent should be pursued, the Administration would draft the relevant legislative proposals for consultation. Details of the supervisory arrangements and reporting arrangements would be considered in that context.

20. Responding to the Chairman, PSFS advised that in line with the practice adopted by other financial services regulators in Hong Kong, international trend and the IMF's recommendation, the Administration intended to fully recover the operating cost of the independent IA from the industry in future. As the consultation was still on-going, the Administration would continue to discuss with the industry on the proposal for the IA to be self-financing.

21. Mr CHAN Kam-lam pointed out that at present, around 60% of the operating cost of the IA was funded by the Government and 40% by licence fees paid by insurance companies. If the operating cost of the IA would be fully recovered from the insurance industry, it would impose a great burden on the industry. Moreover, any possible increase in operating cost of the IA would have significant implications on the level of licence fees. COI advised that at present, each insurance company was required to pay an annual licence fee of over \$200,000 regardless of its scale of business. The Administration considered that there was room for reviewing the existing structure for charging licence fees irrespective of whether the IA would be independent of the Government. Mr CHAN considered that one of the possible options was for the licence fees to be charged on the basis of the amount of premiums earned by the insurance company concerned. He enquired about the Administration's assessment of the impact of this option on the level of premiums. COI considered that the impact should not be great. He pointed out that the annual operating cost of the COI was around \$100 million, which was less than 0.1% of the total premium received by insurance companies in 2002 (\$89 billion). Moreover, it was expected that premiums would continue to fall with growing business volume.

22. Mr James TIEN pointed out that the business sector was mainly concerned about the impact of the independence of the IA on the level of premiums, and whether the IA could perform more effectively after its independence. PSFS advised that the IA had no remit in law to interfere with the operation of the market. There was no way in which the existing or future IA could prescribe a premium level for insurance policies.

23. Referring to paragraph 8 of the paper, Mr James TO noted that the industry was concerned that the new IA would be independent in name only, and was concerned about the possible lack of independence of the IA from political and governmental influence. Mr TO requested the Administration to address this issue. PSFS reiterated that the Administration would consult the Panel again with more detailed information after further discussions with the industry.

24. Referring to paragraph 11 of the paper, Mr NG Leung-sing was pleased to note that the Administration would ensure that there were adequate checks and balances in law regarding the powers of the future IA. Responding to Mr NG's enquiry, COI said that provisions on the governance of the IA would be included in the proposed legislation.

25. Mr James TIEN pointed out that under the existing arrangement, the Government would be the provider of last resort for certain types of insurance under very special circumstances. He was concerned whether the arrangement would be maintained after the independence of the IA. PSFS confirmed that there would be no change to the existing arrangement and that the Government would step in when there were catastrophic incidents, irrespective of whether the IA was independent.

Head of the independent IA

26. Quoting the establishment of the Mandatory Provident Fund Schemes Authority as an example, Mr James TIEN pointed out that it was not uncommon for the senior government official who was in charge of a legislative proposal for the establishment of a statutory authority to take up the post of the head of the authority after its establishment. He was concerned whether the same would happen for the IA. COI responded that as a civil servant, he was subject to posting arrangement of the management. Mr James TO shared Mr TIEN's concern and urged the Administration to be impartial in appointing the head of statutory authorities.

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Conclusion

27. Mr James TIEN said that Members of the Liberal Party would reserve their position on the proposal until more information on the operating cost and governance of the IA after independence was available. Mr CHAN Kam-lam said that Members of the Democratic Alliance for Betterment of Hong Kong held the same stance. Mr James TO said that Members of the Democratic Party had not yet discussed the proposal but he himself had great reservation on the proposal. However, he was prepared to further consider the proposal when more detailed information was available.

V. Up-date on the progress of the Corporate Governance Action Plan

(LC Paper No. CB(1)212/03-04(04) — Paper provided by the Administration

LC Paper No. CB(1)700/02-03 — Paper on "Enhancing Corporate Governance"

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| LC Paper No. CB(1)716/02-03 | — Paper on “The Chief Executive 2003 Policy Address — Initiatives under the Financial Services and the Treasury Bureau” |
| LC Paper No. CB(1)2487/02-03 | — Consultation Paper on the proposals to enhance the oversight of the public interest activities of auditors and to establish a Financial Reporting Review Panel |
| LC Paper No. CB(1)2545/02-03 | — Consultation paper on proposals to enhance the regulation of listing) |

Briefing on the progress of the Corporate Governance Action Plan

28. At the invitation of the Chairman, the Secretary for Financial Services and the Treasury (SFST), Mr Andrew SHENG, Chairman of the Securities and Futures Commission, and Mr Paul CHOW, Chief Executive of the Hong Kong Exchanges and Clearing Limited (HKEx) briefed members on the work of the Administration, SFC and HKEx in implementing the Corporate Governance Action Plan (the Action Plan) respectively. The Action Plan drawn up in January 2003 had identified five priority areas, namely upgrading the Listing Rules and listing functions, tightening the regulation of Initial Public Offering (IPO) intermediaries, effective roll out of the Securities and Futures Ordinance (SFO), successful completion of the Standing Committee on Company Law Reform’s (SCCLR) Phase II Corporate Governance Review, and early implementation of SCCLR’s recommendations from its Phase I Corporate Governance Review. Mr Richard WILLIAMS, Head of Listing of HKEx also updated members on the work progress of HKEx in the first two priority areas.

29. SFST, Mr Andrew SHENG and Mr Paul CHOW stressed the importance of upgrading the corporate governance standards in Hong Kong in line with international standards with a view to enhancing protection for investors and quality of the market, as well as reinforcing Hong Kong’s position as an international financial centre and a premier capital formation centre for the Mainland. They assured members that the Administration, SFC and HKEx would cooperate closely in implementing the Action Plan.

(*Post-meeting note:* The speaking notes by SFST, Mr Andrew SHENG, Mr Paul CHOW and Mr Richard WILLIAMS were issued to members vide LC Paper No. CB(1)293/03-04 on 13 November 2003.)

Discussion

Training for company directors

30. Mr James TIEN, Mr Henry WU and Ms Emily LAU considered that the Action Plan was a move in the right direction in enhancing corporate governance of companies. Noting the important role played by company directors in the process, they welcomed the Government's initiatives in strengthening the training for directors of listed companies, and enquired about the relevant details. Anticipating that there would be a great demand for such training courses, Mr WU suggested that more organizations, such as professional bodies and securities business bodies, should be allowed to provide the training courses.

31. In response, SFST pointed out that SFC, HKEx and the Hong Kong Institute of Directors (HKIoD) had been taking a proactive role in upgrading the corporate governance standards of companies and the Administration was supportive of their work. In this connection, the Administration had provided funds under the Small and Medium Enterprises (SMEs) Funding Schemes for HKIoD to publish a handbook for SMEs to help them build up a solid foundation for achieving good corporate governance. In respect of training for directors of listed companies, SFST stressed that suitable training would enable directors to gain a better understanding of their role and duties, as well as the requirements they needed to comply with under the Listing Rules. SFC, HKEx and HKIoD were working on the relevant details.

32. Mr Andrew SHENG assured members that SFC was committed to working closely with the Administration, HKEx, HKID and other professional bodies to strengthen the training for directors of listed companies. He considered that more formalized training for company directors was essential to update them on the relevant legislation, codes of practices and Listing Rules so as to keep them abreast of the latest changes and international developments. The relevant details, including the issue of whether the training should be voluntary or mandatory, had yet to be decided. If mandatory training for directors were to be introduced, amendments to the Listing Rules would be required. Mr SHENG stressed that SFC would take into consideration the views of Members and various stakeholders in working out the details.

33. Mr Paul CHOW pointed out that the Listing Committee had completed examination of the draft Code on Corporate Governance Practices (the Code). One of the important elements of the draft Code was that persons who served as company directors for the first time were required to receive training while persons who were serving as company directors were encouraged to pursue continuous training. The Listing Committee considered that views of the market should be sought on the proposed phased implementation of the Code. HKEx aimed to publish the draft Code by the end of 2003. As regards provision of training courses for directors, Mr CHOW advised that HKEx, HKID and the Hong Kong Securities Institute were finalizing the course contents. It was expected that HKIoD would announce the details in a few months' time.

34. Responding to Mr James TIEN's enquiry about the timeframe for training of company directors, SEST advised that it was an on-going task to be conducted on a long-term basis.

35. Ms Emily LAU was concerned about the current situation where only a limited number of people were willing to serve as non-executive directors for companies in Hong Kong. In response, SEST pointed out that he had written an article under his column "FSTB and You" in September 2003 to encourage serving or retired professionals, such as accountants and lawyers, to serve as independent non-executive directors of companies. The Administration believed that these professionals would help enhance the corporate governance standards in Hong Kong and strengthen Hong Kong's status as an international financial centre.

36. Given the public concern and interest expressed by various parties about the need to enhance the quality of company directors, Ms Emily LAU suggested that the Panel should consider inviting views from interested parties on the subject.

Improvement of listing functions

37. Ms Emily LAU enquired about the progress of the initiatives for improving listing functions. SEST advised that the Administration had followed up the recommendations put forward by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure in March 2003 and issued a consultation paper on 3 October 2003 to seek public views on the proposals to enhance the regulation of listing. The consultation would close on 31 December 2003. The Administration planned to report the outcome of the consultation and seek Members' views on the way forward at the Panel meeting in April 2004.

38. Mr James TIEN enquired how the listing process could be enhanced to ensure the quality of companies before their applications for listing were approved. Mr Paul CHOW advised that the Listing Committee would ensure that the companies concerned had met all the requirements for listing, including the requirements for risk disclosures and proper sponsors, before approving their applications. He assured Members that HKEx would strike a proper balance between the need to ensure the quality of companies seeking listing to enhance protection for investors and the need to maintain the competitiveness of Hong Kong as a capital formation centre in Asia.

39. Given the increasing number of Mainland companies listed in Hong Kong and the differences in the regulatory regimes in both places, Mr SIN Chung-kai expressed concern over the difficulties of SFC in regulating listed companies incorporated in the Mainland. In response, SEST emphasized that irrespective of the jurisdictions of incorporation, companies listed in Hong Kong had to comply with relevant laws of Hong Kong and the Listing Rules of HKEx. Mr Andrew SHENG stressed that SFC maintained close cooperation with securities regulators of other jurisdictions on matters of mutual concerns and interests. SFC had been cooperating closely with the

China Securities Regulatory Commission (CSRC) on regulatory matters of listed companies in respective markets, and had entered into Memoranda of Understanding with CSRC specifying areas of investigatory cooperation and information exchange. Responding to Mr SIN's enquiry on whether market regulators could conduct investigations on misconduct of listed companies in other jurisdictions, Mr SHENG said that this depended on the legal systems of respective jurisdictions and the specific arrangements agreed between the regulators.

Tightening the regulation of IPO intermediaries

40. Mr James TIEN considered that apart from company directors, professionals such as accountants, auditors, and financial advisers also played a vital role in ensuring the quality of listed companies. SEST shared Mr TIEN's views that regulation of IPO intermediaries, including sponsors and financial advisers, should be tightened. He pointed out that a Member's Bill to be sponsored by Mr Eric LI for enhancing the regulation of the accountancy profession would be shortly introduced into LegCo.

41. On enhancing the professional standards of accountants, Mr Eric LI stressed the commitment of the Hong Kong Society of Accountants (HKSA) to improve the regulatory regime of the accountancy profession. Apart from the introduction of a Member's Bill into LegCo by himself, HKSA would regularly update the professional and ethical standards and guidelines. Any member of HKSA who did not comply with the promulgated standards and guidelines would be subject to disciplinary actions by HKSA and might be removed from the register of professional accountants.

Review of the Companies Ordinance

42. Ms Emily LAU noted that a number of measures under the Action Plan were related to amendments to the Companies Ordinance (CO) (Cap. 32). On the Companies (Amendment) Bill 2003 which had been introduced into LegCo on 25 June 2003, Ms Emily LAU expressed concern that as the Bill involved a number of complex proposals, the relevant Bills Committee might not be able to complete scrutiny of the Bill before the end of the current legislative term in July 2004. She suggested the Administration to consider excising some of the proposals from the Bill.

43. Ms Emily LAU also expressed concern about the progress of the comprehensive review of CO. SEST advised that a comprehensive review on the Ordinance had been conducted in 1993 where divergent views were found on a number of proposals. In view of the importance of providing an up-to-date regulatory framework for companies to cater for the developments in Hong Kong and to keep the regime in line with international standards, the Administration had embarked on an internal study on the subject several months before. Due to complexity of the issues involved, the study had taken much longer time than expected. SEST appreciated Ms LAU's concern and undertook to expedite the review. Upon Ms LAU's request,

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SFST agreed to report the outcome of the review to the Panel within the first quarter of 2004.

Role of Government officials appointed as directors of listed companies

44. Mr Eric LI was pleased to note that the implementation of the Action Plan had achieved good progress. He however expressed concern about the possible conflicting roles of the Government officials appointed as directors in listed companies because they were required to act in the interest of the shareholders of the companies on the one hand, and to act in the public interest on the other. SFST said that as the director of public corporations, such as the Mass Transit Railway Corporation, his role was to monitor the performance of the corporations to safeguard the Government's investments as well as the public interests. The question of conflicting roles did not arise. SFST also pointed out that he had discussed the issue with some other senior Government officials and they might consider seeking the advice of the Department of Justice when there was a need to do so.

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

(LC Paper No. CB(1)212/03-04(05) — Paper provided by the Administration)

Briefing on the work of HKMA

45. At the Chairman's invitation, the Chief Executive, HKMA (CE/HKMA) gave a power-point presentation on HKMA's major areas of work. CE/HKMA highlighted the following points:

- (a) On currency stability, the Hong Kong dollar/US dollar spot exchange rate had remained stable until a marked strengthening from 22 September 2003. The Hong Kong dollar interest rates had correspondingly fallen below US dollar rates, and the negative spread had widened since late September 2003.
- (b) On market expectations on currency, there was recently a marked shift of expectation from weakness to strength as illustrated by the 12-month forward exchange rate moving from a premium to a discount compared with the spot exchange rate. There was considerable covering of short Hong Kong dollar positions, quickly eliminating the premium and producing a discount of nearly 400 points. The one-year forward exchange rate appreciated sharply to below 7.70 in early October 2003 but had since moved gradually back towards 7.80.
- (c) There were three external factors affecting the risks and vulnerabilities of currency, namely, the improving global economic outlook, volatile

exchange rates among G3 currencies and the intensified international political pressure on the renminbi (RMB) exchange rate policy. As regards domestic factors, the recent economic recovery in Hong Kong, robust current account surplus and net international investment position had contributed to the strength of Hong Kong dollar, while concerns about the budget deficit, high unemployment rate and persistent deflation continued to pose risks to the stability of Hong Kong dollar.

- (d) Fiscal drawdowns increased in the face of budget deficit. Some of the fiscal drawdowns were accommodated by the sale of foreign currency assets, thus providing some support to the Hong Kong dollar.
- (e) The banking system had remained sound and the banking sector had maintained good performance in recent years, notwithstanding the fact that the sector had gone through the most difficult period involving the Asian financial turmoil, currency attack, the bursting of the property bubble and of the global information technology bubble, continuing deflation and high level of unemployment. The average consolidated capital adequacy ratio of all locally incorporated authorized institutions (AIs) stood at over 15%, which was well over the minimum international standard of 8%. AIs' overall asset quality improved in the second quarter of 2003. The number of personal bankruptcy petitions decreased for the fourth straight month in September 2003. As regards the number of mortgage loans in negative equity, HKMA was collating the figure as at end September 2003. It was expected that the figure would fall below 100 000. Nonetheless, as a result of the outbreak of the Severe Acute Respiratory Syndrome, most retail banks had recorded a decline in profit in the first half of 2003, as compared with the same period in 2002.
- (f) To enhance the protection of depositors and consumers in the banking sector, HKMA had put forward the legislative proposal for the implementation of the deposit protection scheme and the relevant bill was being scrutinized by LegCo, and issued a statutory guideline on sharing and use of consumer credit data. As regards the recent Automatic Teller Machine (ATM) fraud cases, HKMA had been liaising closely with the Police and AIs in tackling the problem.
- (g) To upgrade Hong Kong's financial infrastructure, HKMA had established linkages with important global debt securities clearing systems, such as the two-way linkages between the Central Moneymarkets Unit and Euroclear/Clearstream. The US dollar and Euro Real Time Gross Settlement Clearing systems in Hong Kong also

allowed financial institutions in Hong Kong and in the region to settle US dollar and euro transactions real-time in the Asian time zone.

- (h) Following the announcement by the Chief Executive on 25 July 2003 that the Central Government would actively consider allowing banks in Hong Kong to run personal RMB business on a trial basis, discussions between HKMA and the People's Bank of China had intensified on working out a detailed scheme and good progress had been made.
- (i) As better credit rating for Hong Kong would enhance the cost-effectiveness of borrowings by the Exchange Fund (EF) and reduce the funding costs of corporate borrowers, HKMA had appointed two Joint Rating Advisors in July 2003 to assist in the production of a Hong Kong credit story to address the credit rating agencies' concerns and to present Hong Kong's credit strengths. The Advisors had also formulated a communication strategy to proactively approach the rating agencies. These efforts had resulted in the recent upgrade by Moody's on Hong Kong' sovereign rating for long-term foreign currency from A3 to A1.
- (j) As regards the performance of EF, for the period of January to September 2003, EF recorded an investment income of \$56.2 billion among which \$17.1 billion was the share to the fiscal reserves placed with EF. This amount had already exceeded the budgeted amount of \$12.1 billion in the 2003-04 Budget. As at 30 September 2003, total assets of EF stood at \$979.9 billion.

(*Post-meeting note:* The supplementary information tabled by HKMA at the meeting was issued to members vide LC Paper No. CB(1)293/03-04 on 13 November 2003.)

Discussion

RMB exchange rate policy

46. Referring to Chart 8 of the presentation material, Ms Emily LAU noted that there were increased calls, particularly from the US, for a revaluation of RMB or more flexible management of its exchange rate. Ms LAU enquired whether the RMB exchange rate policy would likely be changed in the near future and if it would, the impact of the change on Hong Kong's economy and the stability of Hong Kong dollar.

47. CE/HKMA pointed out that despite increasing international political pressure, the Mainland authorities had recently indicated that RMB exchange rate stability was in the interests of China and its neighbouring economies, including Hong Kong. CE/HKMA was of the view that a change in RMB exchange rate was neither

necessary nor justified given that the current account surplus maintained by the Mainland was only about 1% of its Gross Domestic Product. Nonetheless, it was a challenge for the Mainland authorities to deal with the huge capital inflow, which had boosted foreign currency reserves to over US\$400 billion. CE/HKMA also considered that the best way was to liberalize Mainland's capital accounts progressively. Relaxation in capital flows from the Mainland would benefit Hong Kong in terms of increasing investments from the Mainland.

48. As regards the impact of a change in RMB exchange rate policy on Hong Kong, CE/HKMA remarked that a rise in RMB exchange rate would in theory help expedite price equalisation between Hong Kong and the Mainland, and ease deflation problem in Hong Kong. It was unnecessary for Hong Kong dollar exchange rate to follow suit. In fact, the movements in RMB and Hong Kong dollar exchange rates had diverged over the past years. CE/HKMA also pointed out that the actual impact on Hong Kong would depend on market sentiments and perception about the change. In view of the complexity of the issues involved, CE/HKMA said that more analysis on the subject would enhance understanding and help mitigate possible risks arising from misunderstanding. HKMA would continue to provide analysis and research on the subject.

Proposal to develop personal RMB business in Hong Kong

49. Ms Emily LAU enquired about the details of the proposal to develop personal RMB business in Hong Kong. CE/HKMA advised that in order to facilitate the growing economic and financial integration between Hong Kong and the Mainland, and to cater for the need of Mainland tourists visiting Hong Kong and vice versa, it was necessary to provide an efficient channel for legitimate RMB flows across the border, and to gradually build up the infrastructure for RMB in Hong Kong to capture any intermediation activities in the future as the Mainland liberalized its capital markets. Against such background, HKMA had initiated discussions with the Mainland authorities on the proposal two years before. The proposal would involve a trial scheme under which banks in Hong Kong would be allowed to provide personal RMB service to customers, and the appointment of a bank in Hong Kong to act as the clearing bank for RMB. HKMA and the People's Bank of China had intensified their discussions on the proposal with a view to announcing the details before the end of 2003.

ATM fraud

50. Expressing concern about the recent ATM fraud cases, Mr NG Leung-sing and Mr SIN Chung-kai enquired about HKMA's follow-up actions and proposed measures to tackle the problem. They stressed the need to upgrade technology and security measures in ATM systems in order to prevent recurrence of similar incidents and restore customers' confidence on ATMs, and to strengthen Police patrol at blackspots to prevent related criminal activities.

51. In response, CE/HKMA advised that as at 5 November 2003, 36 suspected ATM fraud cases involving six banks and a total of \$1.9 million had been reported in 2003. So far, 21 cases had been resolved with the customers compensated for the loss. HKMA took the matter seriously and had been liaising with AIs and the Police in taking follow-up actions. It had issued a circular to all AIs setting out its expectation on the precautionary measures and the ways for handling customer complaints AIs should adopt in relation to suspected ATM fraud cases. Recommendations of precautionary measures included enhancing the security safeguards of ATMs, installation of closed-circuit televisions, enhancing customer education on the protection of ATM cards and Personal Identification Numbers, and setting up a mechanism to identify transactions made through counterfeit cards. AIs were also advised to patrol their ATMs more frequently during and after office hours. In this regard, AIs were advised to discuss with the Police on the patrolling arrangements for ATMs located in less secured areas. On the other hand, AIs were required to ensure that related customers complaints were efficiently dealt with and referred to the Police for investigation. CE/HKMA added that AIs were expected to step up the relevant security measures by the end of January 2004. He assured members that HKMA would monitor the progress of AIs in implementing the appropriate precautionary measures. The Executive Director of HKMA supplemented that the long-term solution to the problem was to upgrade the security systems of ATM networks and improve the design of ATM cards. As complex technical issues were involved and in order to avoid causing inconvenience to customers, HKMA, the banking sector and the ATM network providers required more time to examine relevant proposals in detail.

Debt papers held in the banking sector

52. Noting that AIs had been holding a substantial amount of their assets in the form of debt securities, Mr James TO expressed concern over deterioration in the overall asset quality of the banking sector resulting from increase in interest rates. He enquired about the measures introduced by HKMA to address the problem.

53. In reply, CE/HKMA said that due to falling loan-to-deposit ratio and increasing surplus liquidity in the banking sector in recent years, AIs had increased their investments in higher yield instruments such as bonds and debt securities. While HKMA had not stipulated any rules on the amount of debt securities that an AI could hold in its asset portfolio, it had constantly alert AIs on the possible risks involved and reminded them of their responsibility to manage the risks prudently. There were already HKMA guidelines on credit interest rate and market risks. At Mr James TO's request, CE/HKMA agreed to provide information on the analysis conducted by HKMA on the holding of debt papers by AIs, including charts showing changes in recent years, information about when HKMA commenced the analysis, and the follow-up actions taken.

Non-banking activities conducted by AIs

54. Mr Henry WU was concerned that HKMA would become a super regulator in the financial services industry when AIs engaged in more and more non-banking business activities, such as securities and insurance. CE/HKMA stressed that while HKMA regulated AIs on a consolidated basis, it had entered into Memoranda of Understanding (MOU) with other regulators in the financial services industry to set out respective roles and duties in supervising AIs in the conduct of non-banking activities with a view to ensuring that there would be no regulatory overlap nor gap. For instance, the Monetary Authority and Insurance Authority (IA) signed a Memorandum of Understanding on 19 September 2003 to coordinate the supervision of the insurance-related activities of AIs. Moreover, HKMA also cooperated closely with other regulators on matters of mutual concern under a cross-sector working group for financial services industry chaired by FS. At Mr WU's request, CE/HKMA undertook to provide a copy of the MOU signed with IA.

55. As regards concern about the dual regulator regime enshrined under SFO under which securities business of AIs were regulated by both HKMA and SFC, CE/HKMA stressed that the regime had proven effective and suitable for Hong Kong. At Mr Henry WU's request, CE/HKMA undertook to provide information on the number and outcome of inspections on AIs' securities business since the commencement of SFO in April 2003.

Appropriate level of fiscal reserves and stability of Hong Kong dollar

56. Mr Jasper TSANG pointed out that the Administration had repeatedly stressed that elimination of budget deficit was a key to maintain the integrity of the Linked Exchange Rate system. Given the strong market confidence on Hong Kong dollar as shown by the large discount in the 12-month Hong Kong dollar forward exchange rate in late September 2003 despite the budget deficit and unemployment problem, Mr TSANG questioned whether the deficit problem had an adverse impact on the stability of Hong Kong dollar. Referring to the recent decision of FS to defer the timeline for restoring balance in the Government's Operating Account to 2008-2009, Mr TSANG further sought CE/HKMA's view on the urgency of tackling the budget deficit problem.

57. On the strength of Hong Kong dollar seen in late September 2003, CE/HKMA explained that the rise in Hong Kong dollar exchange rate was a temporary phenomenon reflecting a shift of market expectation of Hong Kong dollar from weakness to strength triggered by a weakening of US dollar, speculation of appreciation in RMB arising from intensified international political pressure, and considerable covering of short Hong Kong dollar positions. The discount in the 12-month Hong Kong dollar forward exchange rate had been narrowed since early October 2003. CE/HKMA said that the fiscal position would impact on the stability of Hong Kong dollar. He cautioned that continuous concerns about the budget deficit

problem, high unemployment rate and prolonged deflation were negative factors affecting the confidence on and stability of Hong Kong dollar. Notwithstanding that the market had reacted calmly to FS's revised timetable for tackling the budget deficit problem, market sentiments could change rapidly. As such, these risk factors should not be taken lightly.

58. In view of increasing fiscal drawdowns from EF to meet budget deficit, Mr LEE Cheuk-yan expressed concerns about depletion of the fiscal reserves and shrinkage in the amount placed with EF, thus exerting pressure on the stability of Hong Kong dollar.

59. In response, CE/HKMA pointed out that the huge budget deficit of \$78 billion estimated for 2003-2004 would increase the fiscal drawdowns from EF. If high budget deficit persisted in coming years, the level of fiscal reserves would continue to fall, thus reducing the Administration's share of EF investment return. CE/HKMA noted that FS had undertaken to consult various sectors on the appropriate level of fiscal reserves. CE/HKMA remarked that there was no formula for working out the appropriate amount that could instil public confidence on the currency. Economic situations such as performance of the economy, problems of unemployment, deflation, and budget deficit, as well as market sentiments were important factors affecting the stability of a currency and should be taken into consideration.

60. As regards ways to address the budget deficit problem, CE/HKMA advised that the subject was within the purview of FS. In his opinion, while it would be inappropriate for the Administration to raise loans or sell its assets to meet operating deficits, these were viable options for meeting non-recurrent expenses of the Government when market conditions were favourable.

Performance of EF

61. Responding to Mr NG Leung-sing's concern about possible increase in interest rates and effect on the investment return of EF, CE/HKMA explained that generally, increases in interest rates would lead to a fall in prices of debt securities and would in turn adversely affect the investment return of EF. Indeed, income from debt securities had reverted from a gain of \$19.2 billion in the first two quarters of 2003 to a loss of \$0.9 billion in the third quarter. Given the uncertainty in interest rates movement in the future, HKMA had adjusted the investment portfolio of EF to increase the holding of equities to over 20% of the total assets in accordance with approved guidelines. CE/HKMA assured members that HKMA would closely monitor changes in interest rates and review EF investment strategy accordingly.

62. On the overall performance of EF for 2003, CE/HKMA hoped that the target investment income of \$12.1 billion for the fiscal reserve for 2003-2004 could be achieved. However, given the uncertainties in the global financial markets and

fluctuations in investment income in recent months, it was difficult to predict the overall performance of EF for 2003 at this stage.

63. In reply to Mr NG Leung-sing's enquiry on the increase of about \$20 billion in "other liabilities" during the period from December 2002 to September 2003 as shown in the balance sheet of EF, CE/HKMA explained that this was partly due to unsettled transactions in investments and reflected loans obtained from the market. Because of the low interest rates in the market, HKMA had borrowed from the market instead of selling assets of EF to fund part of the fiscal drawdowns.

HKMA's new accommodation

64. Ms Emily LAU enquired about the disposal of surplus office space in HKMA's new accommodation in Two International Finance Centre. CE/HKMA advised that in order to make the best use of the surplus office space, HKMA had rented out all surplus space in the new accommodation to other bodies, such as the International Monetary Fund and Bank for International Settlements. Ms LAU pointed out that some members of the public had expressed concern about whether it was appropriate for HKMA to participate in the rental market as a landlord. At the request of Ms LAU, CE/HKMA agreed to provide further information on the leasing of surplus space in HKMA's new accommodation, including a name list of the tenants and details of the rentals involved.

(Post-meeting note: The information provided by HKMA in response to members' request mentioned in paragraphs 53, 54, 55 and 64 was issued to members vide LC Paper No. CB(1)433/03-04 on 26 November 2003.)

VII. Any other business

65. There being no other business, the meeting ended at 12:45 pm.