

立法會
Legislative Council

LC Paper No. CB(1)2255/03-04

(These minutes have been seen
by the Administration)

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Panel on Financial Affairs

**Minutes of meeting
held on Monday, 3 May 2004 at 10:00 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
Dr Hon David CHU Yu-lin, JP
Hon Albert HO Chun-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 CHAN Kam-lam, JP
Hon Jasper TSANG Yok-sing, GBS, JP
Hon Emily LAU Wai-hing, JP
Hon Abraham SHEK Lai-him, JP

Non-Panel Member : Hon Howard YOUNG, SBS, JP
attending

Members absent : Hon LEE Cheuk-yan
Hon Bernard CHAN, JP
Hon SIN Chung-kai
Dr Hon Philip WONG Yu-hong, GBS

**Public officers
attending**

: Agenda Item IV

Mr Martin GLASS
Deputy Secretary for Financial Services and
the Treasury (Treasury)2

Mr Allen LEUNG
Principal Assistant Secretary for Financial Services and
the Treasury (Treasury) (MA)

Mr Charlix WONG
Senior Treasury Accountant (MA)2

Agenda Item V

Mr Joseph YAM, GBS, JP
Chief Executive

Mr Norman CHAN, SBS, JP
Deputy Chief Executive

Mr Raymond LI, JP
Deputy Chief Executive (Acting)

Mr Eddie YUE, JP
Executive Director

Agenda Item VI

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

Ms Shirley LAM
Principal Assistant Secretary for Financial Services and
the Treasury (Financial Services)

**Attendance by
invitation**

: Agenda Item VI

Hong Kong Society of Accountants

Mr Roger BEST
President

Ms Winnie CHEUNG
Chief Executive & Registrar

Mr F K AU
Legal representative

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

Staff in attendance : Ms Pauline NG
Assistant Secretary General 1

Ms Connie SZETO
Senior Council Secretary (1)4

Ms May LEUNG
Legislative Assistant

Agenda Item VI

Mr KAU Kin-wah
Assistant Legal Adviser 6

I. Confirmation of minutes of meeting
(LC Paper No. CB(1)1630/03-04 — Minutes of meeting on
1 March 2004)

The minutes of the meeting held on 1 March 2004 were confirmed.

II. Information paper issued since last meeting

2. Members noted that no information paper had been issued since the last regular meeting held on 2 April 2004.

III. Date of next meeting and items for discussion

(LC Paper No. CB(1)1629/03-04(01) — List of outstanding items for discussion

LC Paper No. CB(1)1629/03-04(02) — List of follow-up actions)

3. The Chairman informed members that the Administration had proposed the following three items for discussion at the next regular meeting to be held on Monday, 7 June 2004:

- (a) Briefing by the Financial Secretary on Hong Kong's latest overall economic situation;
- (b) Briefing on the implementation of the Basel New Capital Accord in Hong Kong; and
- (c) Progress of the establishment of a commercial credit reference agency in Hong Kong.

4. The Chairman pointed out that as agreed in October 2003, the Financial Secretary (FS) would attend a meeting of the Panel to further discuss with members on the Hong Kong Harbour Fest (the Festival) after the accounts of the Festival had been audited. The FS Office had suggested that an additional item be placed on the agenda for the Panel meeting on 7 June for FS to discuss with members on the subject. The Clerk had just issued a circular to invite members' views on the suggestion. As such, the agenda for the meeting would be finalized later. The Chairman pointed out that if the suggestion was accepted by members, the two items in paragraph 3(b) and (c) above might have to be deferred to the regular Panel meeting in July.

(Post-meeting note: As proposed by FS and with the concurrence of the Chairman, the regular Panel meeting for June was postponed to 14 June 2004 to enable FS to take up a major Mainland trip in early June. The following items were placed on the agenda:

- (a) Briefing by FS on Hong Kong's latest overall economic situation; and
- (b) Hong Kong Harbour Fest.)

IV. Proposed resolution to authorize the Government to transfer \$40 billion from the Land Fund to the General Revenue Account

(LC Paper No. CB(1)1629/03-04(03) — Paper provided by the Administration)

Briefing by the Administration

5. At the Chairman's invitation, the Deputy Secretary for Financial Services and the Treasury (Treasury)2 (DS(Tsy)2) briefed Members on the proposed resolution under the Public Finance Ordinance (Cap. 2) to authorize the Government to transfer \$40 billion from the Land Fund (LF) to the General Revenue Account (GRA) and invite their views on the way forward for the LF. He highlighted the following points:

- (a) The fiscal reserves comprised the accumulated balances of the GRA, LF, Capital Works Reserves Fund (CWRP), Capital Investment Fund, Loan Fund, Civil Service Pension Reserve Fund, Disaster Relief Fund, Innovation and Technology Fund, and Lotteries Fund.
- (b) The LF was established on 1 July 1997 by a resolution of the Provisional Legislative Council to receive and hold all the assets, net of expenses, transferred from the Hong Kong Special Administrative Region Government Land Fund (HKSARGLF). From the tenor of the resolution, the LF could only be used for investment and not for the provision of any Government services. There was no provision to allow the Government to transfer money from the LF to the GRA or other Government funds.
- (c) From 1 July 1997 onwards, the investment of the LF had been managed by the Hong Kong Monetary Authority (HKMA). As at 31 March 2004, the estimated balance of the LF was \$157.7 billion, accounting for 57.3% of the fiscal reserves.
- (d) The Administration moved a resolution at the Legislative Council (LegCo) meeting on 7 May 2003 to authorize the transfer of \$120 billion from the LF to the GRA to cope with the fiscal deficits formerly envisaged for 2003-04 to 2005-06. However, according to an up-dated cashflow forecast, the \$120 billion fund transfer would be insufficient to meet the Government's cashflow requirements. Although it was revealed in the provisional financial results for the 2003-04 financial year released in late April 2004 that the balance of the fiscal reserves was \$8.9 billion more than the revised estimate announced in the 2004-05 Budget, this had not alleviated the Government's cashflow problem in the medium term. As at 31 March 2004, the estimated balance of the GRA was \$75.8 billion. The Administration estimated that there would be shortfall in the GRA in 2004-05 despite that the amount of shortfall would be reduced from \$34 billion to \$28 billion by end of the third quarter of 2004-05. The anticipated shortfall was partly due to the need to transfer funds from the GRA to the CWRP to ensure that there was a sufficient cash balance in the latter to meet capital expenditure requirements before the completion of the planned asset sale/securization as well as the budgeted issuance of \$20 billion Government bonds during 2004-05. It was also necessary to maintain a

sufficient cash balance in the GRA to cope with any possible slippage in the cashflow of the land revenue forecast of \$12 billion in 2004-05 and the deficits in the initial months of 2004-05 and 2005-06.

- (e) The purpose of the proposed resolution was to authorize the Government to transfer \$40 billion from the LF to the GRA in order to meet the latter's anticipated shortfall in 2004-05. The proposal was a measure to transfer funds from one part of the fiscal reserves to meet anticipated shortfall in another part of the reserves. It was not meant to provide the Administration with additional funds to finance its spending which would require LegCo's approval either through the Appropriation Bill at the beginning of a financial year or the Finance Committee in the course of a financial year. The Administration remained committed to enforce strict financial discipline in controlling its expenditure. Subject to Members' views, the Administration would move the proposed resolution at the LegCo meeting on 16 June 2004 to seek authorization for the transfer of funds.
- (f) When moving the resolution to effect the fund transfer of \$120 billion at the LegCo meeting on 7 May 2003, the Administration undertook to examine and consult the Panel on the review of the long-term use of the LF. In the light of the outcome of a preliminary evaluation of the possible uses of the LF and with regard to the current fiscal situation, the Administration considered that there might be a case to dissolve the LF and transfer its balance to the GRA. The main justifications were provided in paragraphs 15 and 16 of the paper provided by the Administration.

Discussion

Proposed resolution to transfer \$40 billion from the LF to the GRA

6. Mr NG Leung-sing declared that he was the one of the trustees of the HKSARGLF for the period from 1988 to 1997. He expressed support for the proposed transfer of \$40 billion from the LF to the GRA for meeting Government's cashflow requirements.

7. Mr CHAN Kam-lam opined that the decision to set up the HKSARGLF in 1986 was appropriate and had saved up part of the income from land premium received prior to 1997 for future use of the HKSARG. Whilst indicating his support for the proposed transfer of \$40 billion from the LF to the GRA to cope with the anticipated budget deficits in the coming years, Mr CHAN stressed that the Administration should continue to adhere to the principle of prudent management of public finances and stepped up its efforts to address the deficit problem by implementing efficiency saving measures and exploring new sources of revenue. Mr Henry WU shared this view.

Preliminary proposal to dissolve the LF

8. Mr Henry WU had reservation over the proposal to dissolve the LF and transfer its balance to the GRA. Whilst appreciating that the proposal would provide the Government with greater flexibility in the management of public finances, Mr WU was concerned that the proposal might undermine LegCo's function in monitoring the use of public funds. He considered that the current mechanism under which the Administration was required to seek LegCo's approval for the transfer of funds from the LF would allow LegCo to consider the need for the transfer on a case-by-case basis, thus ensuring the proper use of public funds.

9. In response, DS(Tsy)2 explained that the Administration had proposed to dissolve the LF because it had not identified any specific purposes for the fund in the long run. He stressed that the proposed transfer of fund balance to the GRA upon dissolution of the LF would remove an artificial distinction between the fund and other parts of the fiscal reserves. This would also be in line with the arrangements for other Government funds that allowed money to be transferred in and out of the funds to other parts of the fiscal reserves. DS(Tsy)2 also pointed out that the proposal would not allow the Administration to squander resources. The Administration could not spend freely as all Government expenditure was subject to LegCo's approval. He assured Members that the Administration was committed to maintaining fiscal prudence and advised that the strategies for restoring fiscal balance by 2008-09 had been set out in the 2004-05 Budget. Major measures included controlling and constraining growth in public expenditure, and raising additional revenue by promoting economic growth.

10. Mr NG Leung-sing considered it advisable to dissolve the LF in the long run and transfer its balance to the GRA. He was however concerned about the arrangements for the staff employed for managing the LF after dissolution of the fund. In this connection, Mr James TIEN enquired whether staff savings could be achieved after the dissolution of the fund.

11. In response, DS(Tsy)2 explained that the assets of the LF, being part of the fiscal reserves, were merged with the Exchange Fund (EF) and managed by HKMA as part of the investment portfolio of the EF. He was not aware that HKMA had maintained a separate team of staff for managing the LF alone. As far as he knew, the staff who managed the HKSARGLF had been absorbed into HKMA when the LF was established in 1997. DS(Tsy)2 also pointed out that dissolution of the LF was simply an accounting change within the fiscal reserves and should have no staffing implications on HKMA. Nonetheless, he undertook to seek information from HKMA on the arrangements for existing staff responsible for managing the LF after dissolution of the fund and staff savings, if any, that could be achieved by the dissolution.

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

(LC Paper No. CB(1)1629/03-04(04) — Hong Kong Monetary Authority — Annual Report 2003

LC Paper No. CB(1)1629/03-04(05) — Power-point presentation material provided by the Hong Kong Monetary Authority

LC Paper No. CB(1)1686/03-04(01) — Operating Expenses of Hong Kong Monetary Authority in 2003)

Briefing on the work of the Hong Kong Monetary Authority

12. At the invitation of the Chairman, the Chief Executive of the Hong Kong Monetary Authority (CE/HKMA) gave a power-point presentation on HKMA's Annual Report 2003 and the updates on its key areas of work. CE/HKMA highlighted the following points:

- (a) In 2003, the Hong Kong dollar continued to be stable under the Linked Exchange Rate (LER) System despite considerable volatility in world currency markets, weakness in domestic economy and public finances. The banking sector also maintained stability during a period of economic difficulty caused by the Severe Acute Respiratory Syndrome (SARS).
- (b) As regards performance of the Exchange Fund (EF), the fund achieved an investment return of \$89.7 billion or 10.2% in 2003, which was 70 basis points above the benchmark set by the Financial Secretary (FS) on the advice of the Exchange Fund Advisory Committee (EFAC).
- (c) On currency stability, the Hong Kong dollar strengthened markedly since the third quarter of 2003. The Currency Board System was working effectively despite the current Aggregate Balance in the clearing accounts of licensed banks had grown to over \$54 billion. It was expected that it would take some time for the interest rate differential against the holding of Hong Kong dollars to generate the outflow necessary for the Aggregate Balance to be reduced to a more normal level.
- (d) Important external factors affecting risks and vulnerabilities of Hong Kong dollar included the upturn in interest rates in the United States (US), political pressure for a revaluation of renminbi (RMB), and implementation of macroeconomic policies in the Mainland. Internally, robust recovery in Hong Kong's economy, continuous growth in its current account surpluses, recent rebound in the property market, and

easing of deflation situation had contributed to the strengthening of Hong Kong dollar.

- (e) On the banking sector performance, the overall asset quality of retail banks improved notably in the fourth quarter of 2003. The number of personal bankruptcy petitions reduced from 4 356 in the fourth quarter of 2003 to 3 363 in the first quarter of 2004. Preliminary figures showed that the number of residential mortgage loans in negative equity had reduced considerably from around 67 600 cases at end of December 2003 to around 40 000 cases in the first quarter of 2004 alongside the pick up in property prices.
- (f) On the enhancement of protection of bank customers, HKMA had required banks to take appropriate precautionary measures and follow-up actions for cases of Automatic Teller Machine (ATM) fraud and fraudulent bank websites. No new cases on ATM fraud had been reported since mid November 2003 and no report of financial loss had been received in respect of fraudulent bank websites cases.
- (g) On work projects in the banking sector, preparatory work for implementation of the New Capital Accord by end of 2006 was underway. HKMA had consulted the banking industry on preliminary proposals and would brief the Panel in July 2004. The Second Reading debate on the Deposit Protection Scheme Bill would be resumed on 5 May 2004 and the Scheme was expected to be launched in 2006. The sharing of positive consumer credit data among banks began in August 2003. The banking industry had appointed a service provider to run the Commercial Credit Reference Agency and was finalising the operational details.
- (h) On the development of financial infrastructure, the Clearing and Settlement Systems Bill was introduced into Legislative Council (LegCo) in December 2003 and was being scrutinized by a Bills Committee. The launching of personal RMB business in Hong Kong had further consolidated Hong Kong's status as an international financial centre. There had been a steady increase in the use of RMB debit and credit cards by Mainland tourists in Hong Kong. Total outstanding RMB deposits in Hong Kong amounted to about RMB \$6 billion by end of April 2004.
- (i) Regarding the performance of EF, an investment income of \$16.8 billion was recorded in the first quarter of 2004. As a result of adverse market conditions in April 2004, EF had suffered losses and the gains recorded in the first quarter had been offset. In view of uncertainties and volatility in global financial markets, the investment outlook of EF in the rest of 2004 was full of risks and challenges. Due to the difficult

investment environment, it was unlikely that the huge gains for EF seen in 2003 would recur.

(*Post-meeting note:* Updated pages of the power-point presentation material were circulated to members vide LC Paper No. CB(1)1712/03-04 on 4 May 2004.)

13. In response to Ms Emily LAU's request in April 2004 for information on HKMA's operating expenditure in 2003, CE/HKMA replied that the information had been provided to Members before the meeting (LC Paper No. CB(1)1681/03-04(01)). He explained that HKMA's operations were funded by EF. The EF operating expenses of \$1,179 million in 2003 was about 0.1% of the total assets of the fund as at end of 2003. Among the EF operating expenses, HKMA's operating expenses amounted to \$614 million, representing a reduction of 6% over 2002. The breakdown of HKMA's total expenses by major block items for 2001 to 2003 was provided in page 2 of the paper, and a further breakdown of the expenses and details of the establishment of HKMA by department was provided at the annexes to the paper.

Discussion

Review of the LER System and stability of Hong Kong dollar

14. Mr James TIEN pointed out that HKMA had repeatedly stressed the importance for Hong Kong to continue implementing the LER System for maintaining the stability of Hong Kong dollar, in particular when the currency was under depreciating pressure in the face of concerns over problems of unemployment and public finances. Referring to recent strengthening of Hong Kong dollar, Mr TIEN enquired about the cause for the appreciating pressure on the currency and sought CE/HKMA's view on whether it was the appropriate time to review the LER System.

15. In response, CE/HKMA remarked that since implementation of the LER System in October 1983, the System had contributed to maintaining the stability of Hong Kong dollar and creating a monetary environment conducive to the economic development of Hong Kong. He stressed that given the small size and external-oriented nature of Hong Kong's economy, a stable currency maintained under the LER System was vital for Hong Kong to withstand external volatility. CE/HKMA added that it was the responsibility of FS to determine the monetary policy objective and the structure of the monetary system for Hong Kong. At present, the monetary policy objective was currency stability which was defined as a stable external exchange value of the Hong Kong dollar in terms of its exchange rate against the US dollar at around HK\$7.8 to US\$1. The exchange rate stability was achieved through a Currency Board System. The Monetary Authority was responsible for achieving the monetary policy objective, including determining the strategy, instruments and operational means for doing so.

16. As regards the recent strengthening in Hong Kong dollar, CE/HKMA explained that this was triggered by the weakening of US dollar and speculation on appreciation of RMB since late 2003. He envisaged that the strengthening of Hong Kong dollar was only a temporary phenomenon. Indeed, there was some outflow of funds since late April 2004 leading to softening of Hong Kong dollar exchange rate. In the short to medium term, market expectations on Hong Kong dollar would hinge on two external factors, i.e. interest rate development in the US and revaluation of RMB exchange rate due to political pressure. In CE/HKMA's view, it was justifiable for RMB to maintain its existing exchange rate and there was no need for Hong Kong dollar exchange rate to follow changes in RMB exchange rate.

17. Given the positive economic outlook for Hong Kong in 2004, Mr James TIEN remarked that the Administration should be less concerned about the problem of fiscal deficit and should shelve the second phase of salaries tax increases passed by LegCo in 2002-03 legislative session.

18. CE/HKMA remarked that notwithstanding favourable domestic factors sustaining economic recovery, the outlook of Hong Kong's economy would be affected by development in the external environment. Latest concerns about the imminent increase in US interest rates and the stepping up of economic tightening measures in the Mainland would have impact on Hong Kong. Coupled with uncertainties in the global investment market, it was not optimistic that the fiscal reserves' share of \$12 billion from the EF's investment income budgeted for 2004-05 could be achieved. As such, there was still pressure for the Administration to tackle the fiscal deficit problem.

19. Pointing out that the SARS outbreak in 2003 had exerted downward pressure on Hong Kong dollar exchange rate, Mr NG Leung-sing asked whether the possible return of SARS would be a risk factor affecting the stability of Hong Kong dollar.

20. In response, CE/HKMA remarked that the SARS outbreak in 2003 had caused grave concerns in the market and dampened confidence in Hong Kong dollar. As the market was more assured of the Government's ability in dealing with the problem with the experience gained in handling the outbreak in 2003, CE/HKMA envisaged that it was unlikely that the possible return of SARS would become a major concern of the market.

21. Referring to the recent comment by CE/HKMA that the stepping up of macroeconomic management measures in the Mainland would pose risks on the stability of Hong Kong dollar, Dr David CHU was concerned that such a comment might have a negative impact on monetary stability in Hong Kong. Dr CHU said that he was confident that the Mainland authorities, through administrative measures, could cool down the over-heated economy and achieve a "soft landing" for the economy.

22. CE/HKMA clarified that given increasing economic integration between Hong Kong and the Mainland, it would be inevitable that implementation of macroeconomic management measures in the Mainland would pose risks to the stability of Hong Kong dollar in the short run. However, these measures, if successfully implemented, could contribute to steady economic development in the Mainland, and would in turn benefit Hong Kong's economy in the long run. He shared Dr David CHU's view that a wide range of market instruments and administrative measures could be employed by the Mainland authorities to tighten up the monetary condition, and curb excessive money growth and credit growth in the Mainland. However, CE/HKMA considered it difficult to predict the results of these measures at this stage although the risk of a hard landing seemed small.

Operation of the Currency Board System

23. Ms Emily LAU remarked that under the Currency Board System, HKMA should act passively to sell Hong Kong dollar in exchange for US dollar in response to market demand resulting from inflow of funds. However, referring to page 28 of the summary version of HKMA's Annual Report 2003, Ms LAU noted that since September 2003, HKMA had intervened many times in the money market to sell Hong Kong dollar, thus causing doubts in the market as to whether HKMA had adopted a more proactive approach in the operation of the Currency Board System. Ms LAU opined that HKMA should clarify its role in conducting market operations. She also expressed concern about the discretionary power conferred to HKMA in this respect and whether such power was subject to proper checks and balances.

24. In response, CE/HKMA advised that under the LER System and the Currency Board System, HKMA should play a passive role in the sale or purchase of Hong Kong dollar or US dollar as appropriate in response to capital inflow or outflow. The purpose of such operations was to avoid excessive deviation of Hong Kong dollar exchange rate from the Link rate of HK\$7.8 to US\$1 so as to maintain monetary stability. At present, while there was a formal Convertibility Undertaking for HKMA to sell US dollar against Hong Kong dollar clearing balances of licensed banks at the fixed rate of 7.8, there was no formal Convertibility Undertaking on the strong side of the Link to buy US dollar. To this extent, HKMA had the discretion to determine at which level of exchange rate it should sell Hong Kong dollar against US dollar when the exchange rate was on the strong side of the Link. There were pros and cons for retaining the discretionary power. On the one hand, the constructive ambiguity inherent in discretion inhibited speculative shorting of Hong Kong dollar and discouraged speculation by making it difficult to calculate the downside risk involved. On the other hand, the total absence of discretionary power might enhance further credibility of the system. Issues relating to the need to provide a formal Convertibility Undertaking on the strong side of the Link and associated discretionary power of HKMA had been discussed by EFAC's Subcommittee on Currency Board Operations. The Subcommittee had affirmed the need for HKMA to retain the discretionary power for the purpose of maintaining currency stability. CE/HKMA stressed that HKMA attached great importance in ensuing credibility of

the Currency Board System and HKMA's market operations. One of the essential elements to increase credibility was through enhancing transparency in operations. Having considered the need to ensure confidentiality and effectiveness of the operations, HKMA had been providing the market with the necessary information after the conduct of such operations.

25. Ms Emily LAU enquired about whether central banking institutions of other jurisdictions, which were operating under a Currency Board System, had similar discretionary power as HKMA. CE/HKMA advised that other economies which operated a Currency Board System were small and not as open as Hong Kong. Their monetary bases mainly composed of money in circulation. In the case of Hong Kong, an essential component of the monetary base was the Aggregate Balance. Due to differences in the nature of the economies and features of the Currency Board Systems, it would be inappropriate to make comparison on the operations of the Systems among various jurisdictions.

Precautionary measures on fraudulent bank websites

26. On precautionary measures to tackle the problem of fraudulent bank websites, Mr NG Leung-sing welcomed HKMA's initiative to promote the public awareness of internet banking security precautions through the launching of consumer education programme. In order to save resources, Mr NG suggested that HKMA should consider seeking the Radio Television Hong Kong's assistance in the production and broadcasting of TV and radio programmes in this regard.

27. In response, CE/HKMA said that HKMA and the banking industry took the matter of fraudulent bank websites seriously and had been monitoring precautionary measures undertaken by banks. In enhancing public awareness of internet banking security precautions, CE/HKMA took note of Mr NG Leung-sing's suggestion and assured members that HKMA would monitor implementation of the consumer education programme to ensure its cost-effectiveness.

RMB business in Hong Kong

28. Mr NG Leung-sing concurred that the provision of personal RMB business in Hong Kong would help the development of local financial infrastructure. He enquired about HKMA's plans, if any, to conduct studies on the development of RMB business in Hong Kong and to assess its impacts on Hong Kong's economy and future development.

29. On the provision of personal RMB business in Hong Kong, CE/HKMA advised that the service was welcomed by both the local people and Mainland tourists as evidenced by the steady increase in RMB deposits and credit card transactions in Hong Kong. HKMA was exploring ways to encourage more RMB money exchange transactions by business establishments through banks. As regards studies on the development of RMB business in Hong Kong, CE/HKMA advised that HKMA had

been undertaking relevant research. In this connection, Mr NG Leung-sing opined that research and assessment on RMB business in Hong Kong would help the banking industry in understanding the market situation and exploring new business opportunities.

HKMA's operating expenditure in 2003

30. Ms Emily LAU pointed out that the information provided by HKMA on the operating expenses of EF and HKMA in 2003 had not covered the details she had requested for. Such details included the breakdown of EF operating expenses by item, the breakdown of market expenses by item, the breakdown of HKMA's expenses by department, HKMA's staff salaries and staff cost by categories of senior and other staff and by department. Ms LAU said that such information was important to facilitate LegCo in monitoring the operation of HKMA. She had reiterated her request for HKMA to provide the above information through the Clerk to the Panel on 30 April 2004. Ms LAU urged HKMA to provide the information as soon as possible.

31. In reply, CE/HKMA reiterated that the EF operating expenses of \$1,179 million in 2003 only represented about 0.1% of the total assets of EF as at end of 2003. The operating expenses were much lower than those of most investment funds in the market and covered many other activities of HKMA on top of those relating to the investment management of EF. As regards details of the operating expenses of EF and HKMA, CE/HKMA reiterated that the information provided to the Panel had been endorsed by EFAC with due regard to the current policy governing disclosure of information on EF and HKMA's existing information management system. HKMA's information management system was established with reference to international standards and the level of information disclosure on HKMA's operating expenses was comparable to that of other central banking institutions. In the light of Ms Emily LAU's request for more information on the operating expenses of EF and HKMA, CE/HKMA undertook to convey her request for consideration by the Governance Sub-Committee (formerly the Remuneration and Finance Sub-committee) of EFAC, which would make recommendations to FS.

(Post-meeting note: The Clerk's letter dated 30 April 2004 to HKMA and HKMA's interim reply were circulated to members vide LC Paper Nos. CB(1)1950/03-04(01) & (02) respectively on 28 May 2004.)

VI. Regulatory regime of professional accountants

(LC Paper No. CB(1)1629/03-04(06) — Legislative Council Brief on “Professional Accountants (Amendment) Bill 2004” dated 24 March 2004)

32. The Chairman said that the Professional Accountants (Amendment) Bill 2004 (the Bill) was a Member's Bill introduced by Dr Eric LI into LegCo on 24 March 2004. At the request of some Members, the House Committee decided at its meeting on 23 April 2004 that the policy issues relating to the Bill should be further discussed by the Panel before a decision was made on whether a bills committee should be formed to study the Bill. Pursuant to the House Committee's decision, arrangements were made for discussing the relevant policy issues at this meeting. Dr LI, representatives of the Hong Kong Society of Accountants (HKSA) and representatives of the Administration were invited to join the discussion.

Briefing by Dr Eric LI

33. At the invitation of the Chairman, Dr Eric LI highlighted the policy issues relating to the Bill. He pointed out that the Bill was introduced against the background where confidence in the accountancy profession had been brought into sharp focus after the corporate scandals in the United States in mid 2002. Given the public concern about the credibility of financial reporting and auditing practices of corporations, a number of jurisdictions had introduced reforms in their regulatory framework governing the accountancy profession. In line with international developments, HKSA had put forward a series of proposals to reform its regulatory regime by making amendments to the Professional Accountants Ordinance (PAO) (Cap. 50). The proposals, which were incorporated into the Bill, included the expansion of the membership of HKSA's Council (the Council) by increasing the number of lay members and elected members, reform of the investigation and disciplinary mechanism under PAO, and the expansion of the immunity provisions in line with those provided for other statutory bodies. Dr LI pointed out that a majority of other proposed amendments were straightforward and technical in nature, such as changing the title of HKSA to the "Hong Kong Institute of Certified Public Accountants" and making consequential amendments to other ordinances and subsidiary legislation. He also pointed out that the proposals under the Bill had the support of a great majority of HKSA's members and the Administration.

34. Dr Eric LI stressed that there was urgency in passing the Bill to ensure an effective, transparent and accountable regulatory regime for the accountancy profession so as to restore public confidence. He was prepared to address any concerns Members might have on the proposed amendments before resuming the Second Reading debate on the Bill.

Discussion

Proposals to reform the regulatory processes of the accountancy profession

35. In reply to Ms Emily LAU's enquiry about details of the proposal of expanding the membership of the Council, Dr Eric LI explained that the proposal aimed to enhance the transparency of the operation of the Council and relieve the heavy workload of its members. Under the Bill, the number of members of the

Council would be increased to 23. Four of them would be lay persons appointed by the Chief Executive to represent the public interest in the Council. These lay members should not be accountants in their current occupation or employment at the time of appointment and throughout their term of office.

36. Noting that the majority of the Council members would still be professional accountants, Ms Emily LAU was concerned how the proposal under the Bill could meet the public aspiration for enhancing public oversight of the accountancy profession. In response, Dr Eric LI pointed out that apart from increasing the number of lay members in the Council, the proposals of reforming HKSA's Investigation Committee and Disciplinary Committee and broadening their powers would enhance public oversight over the conduct and work of professional accountants for proper safeguard of public interest. The proposals were in line with existing arrangements in the regulatory regimes of professional accountants in other jurisdictions.

37. Mr Albert HO pointed out that the proposal of reforming HKSA's Investigation Committee and Disciplinary Committee was related to the latest proposal of establishing an Independent Investigation Board (IIB). As the two proposals involved public interest and had cost implications, Mr HO considered it appropriate for the Administration to take forward the proposals in the form of a Government bill.

38. Dr Eric LI clarified that the Bill did not have any charging effect. The proposal of reforming the investigation and disciplinary mechanism under PAO was the first step taken by HKSA to open up its self-regulatory structure. The HKSA had also proposed to establish an IIB as a longer-term solution to enhance the independence and transparency of its investigation procedures. The proposal to establish an IIB was the subject of a separate bill to be introduced by the Administration. As more time was needed to work out the details of the IIB proposal and prepare the necessary legislative amendments, it was more advisable to enact the Bill first. Dr LI stressed that there was no conflict between the two proposals and in fact they would complement each other.

Consultation on the proposals under the Bill

39. In response to Ms Emily LAU's enquiry about the consultation on the proposals under the Bill, Dr Eric LI advised that the HKSA had conducted a number of meetings to explain the proposals to its members and consult their views. While some members of HKSA had pointed out that the change of title of HKSA would give rise to the need for them to print a new set of firm stationaries etc, no member had raised any objection to the proposals under the Bill on the grounds of public interest. At HKSA's Extraordinary General Meeting held on 7 July 2003, a special resolution on the proposals was passed by a majority vote, with over 90% of the votes supporting the resolution.

40. As regards consultation with the Administration, the Deputy Secretary for Financial Services and the Treasury (Financial Services) advised that the Administration had initiated the discussion with the accountancy profession on the proposals to improve the current regulatory regime in late 2002. It had been working closely with HKSA since then in taking forward the improvement proposals. The Administration believed that the Bill would enhance the public oversight of the accountancy profession and therefore supported its early passage by LegCo.

Way forward

41. Given that professional accountants played an important role in safeguarding the integrity of financial reporting, members appreciated the need to enhance the effectiveness and transparency of the regulatory regime of the accountancy profession to inspire confidence of the investing public. As the Bill covered a wide range of proposals which might have far reaching impacts on the accountancy profession and the public, Ms Emily LAU, Mr James TIEN and Mr Albert HO considered it more prudent for LegCo to form a bills committee to examine the relevant policy and technical issues in detail.

42. Dr Eric LI re-iterated the importance and urgency of the Bill, and stressed the need to expedite the scrutiny of the Bill. He was concerned that if a bills committee was formed to study the Bill, it was unlikely that the legislative procedure could be completed before the end of the current term in July. Dr LI suggested that a subcommittee be formed under the Panel to deliberate on the Bill before the Panel reported back to the House Committee.

43. Mr NG Leung-sing expressed support for the early passage of the Bill and suggested that Members who had any views on the Bill might forward their questions to Dr Eric LI for his written response.

44. Mr James TIEN, Ms Emily LAU and Mr Albert HO considered it more appropriate to follow the established procedures for the scrutiny of bills. To expedite the scrutiny process, the Panel might recommend to the House Committee that priority be given to the scrutiny of the Bill if it was decided that a bills committee should be formed to study the Bill.

45. At the invitation of the Chairman, Assistant Secretary General 1 advised that at present, there were 15 active bills committees and eight on the waiting list. According to the House Rules, the order of bills committees on the waiting list was in the order of the introduction of the relevant bills into LegCo. In acceding to a request of the Administration for priority activation of a bills committee on a Government bill, the order of the bills committees on Member's bills should not be affected as a result. Similarly, should a Member's bill be dealt with ahead of other bills, the order of Government bills should not be altered. The decision on whether a bill was urgent rested with the House Committee. For the present case, the House Committee might have to consider whether a bills committee should be formed to study the Bill and if it

should, whether priority should be given to the bills committee. In making its decision, the House Committee might take into account the urgency of the Bill, availability of a vacant slot, the order of Government bills, and the Administration's views on the priority of bills. ASG1 added that should the House Committee agree that priority be given to the bills committee but there was no vacant slot, the feasibility of increasing the quota of active bills committees from 15 to 16 could be explored, taking into consideration the workload of Members and the Secretariat.

46. Dr Eric LI and other members agreed that the House Committee be requested to give priority to the scrutiny of the Bill if it decided that a bills committee should be formed to study the Bill. Ms Emily LAU suggested that a request should be made to the House Committee to increase the quota of active bills committees from 15 to 16. Pending the House Committee's decision, Dr LI urged Members to leave the option of forming a subcommittee under the Panel open.

47. In order to expedite scrutiny of the Bill, Mr Albert HO suggested that consideration might be given by Dr Eric LI to excise from the Bill the more complex proposals which had public interests, such as those related to the reform of HKSA's Investigation Committee and Disciplinary Committee. Dr Eric LI said that he would consider Mr HO's suggestion. He re-iterated that a majority of the proposals under the Bill were related to internal matters of HKSA and did not involve public interest issues.

Conclusion

48. The Chairman concluded that he would report the Panel's views to the House Committee at its meeting on 7 May 2004. To facilitate the House Committee's consideration, Ms Emily LAU suggested that the Administration's views be sought on whether it had any objection to giving priority to the scrutiny of the Bill. The Clerk undertook to seek the Administration's views on the issue.

(Post-meeting note: The House Committee, at its meeting on 7 May 2004, considered the Panel's report (LC Paper No. CB(1)1721/03-04) and the Director of Administration's reply. It was decided that a bills committee should be formed to study the Bill and that the bills committee be accorded the third priority on the waiting list. The bills committee commenced its work on 21 May 2004.)

VII. Any other business

49. There being no other business, the meeting ended at 12:30 pm.

Council Business Division 1
Legislative Council Secretariat
2 July 2004