

The Monetary Authority was established on 1 April 1993, by merging the Office of the Exchange Fund with the Office of the Commissioner of Banking. This was done to ensure that the official duties in the monetary and banking fields can be performed with a high degree of professionalism and continuity,

in the lead up to 1997 and beyond, in a manner that commands the confidence of the people of Hong Kong and the international financial community.

The origins of the Monetary Authority date back to the establishment of the Exchange Fund under the Exchange Fund Ordinance (Cap 66) of 1935. The Exchange Fund (Amendment) Ordinance 1992, providing for the appointment of the Monetary Authority, was enacted on 10 December 1992 and came into operation on 1 April 1993. Section 5A specifies that the Financial Secretary shall appoint a Monetary Authority to assist him in the performance of his functions under the Exchange Fund Ordinance. The primary purpose of the Exchange Fund, which is under the control of the Financial Secretary, is its use "for such purposes as the Financial Secretary thinks fit affecting, either directly or indirectly, the exchange value of the currency of Hong Kong and for other purposes incidental thereto." [section 3(1)].

In addition to this primary purpose of maintaining currency stability, section 3 (1A) states that "the Financial Secretary may, with a view to maintaining Hong Kong as an international financial centre, use the Fund as he thinks fit to maintain the stability and the integrity of the monetary and financial systems of Hong Kong."

The Exchange Fund (Amendment) Ordinance 1992 also amended the Banking Ordinance to vest the powers

and duties of the Commissioner of Banking in the Monetary Authority with effect from 1 April 1993.

#### **FUNCTIONS OF THE MONETARY AUTHORITY**

The functions of the Monetary Authority are as follows:

- To maintain currency stability, within the framework of the linked exchange rate system, through sound management of the Exchange Fund, monetary policy operations and other means deemed appropriate;
- To ensure the safety and stability of the banking system through the regulation of banking business and the business of taking deposits, and the supervision of authorised institutions; and
- To promote the efficiency, integrity and development of the financial system, particularly payment and settlement arrangements.

These functions are generally consistent with those of central banks around the world. However, unlike other central banks, the Monetary Authority does not fulfil the following functions:

- Note Issue.  
This is currently undertaken by two note issuing banks. As backing for their note issue, the note issuing banks are required to hold non-interest bearing Certificates of Indebtedness issued by the Monetary Authority for the account of the Exchange Fund. In May 1994, the



Bank of China will also become a note issuing bank.

- Clearing House activities.

These are handled satisfactorily by the Clearing House of HKAB.

- Banker to the Government.

Although the bulk of the fiscal reserves of the Government are held at the Exchange Fund, the Monetary Authority does not act as banker to the Government, a function which has been carried out historically by the commercial banks.

The Monetary Authority is an integral part of the Government, but is able to employ staff on terms different from those of the civil service in order to attract personnel of the right experience and expertise. The Chief Executive, being appointed the Monetary Authority by the Financial Secretary, remains a public officer, as do his deputies and staff.

#### **BACKGROUND TO THE CREATION OF THE MONETARY AUTHORITY**

The growing importance of Hong Kong as an international financial centre, and the important inter-relationships between monetary stability, the soundness and integrity of the financial system, and the efficiency and robustness of the financial infrastructure, all require that the official functions should be closely co-ordinated in a single body. The establishment of the Monetary Authority should be understood against the following economic background :

- Monetary stability is crucial to the stability and prosperity of Hong Kong, both in the transitional period and beyond.
- There is a clear requirement in the Joint Declaration that "the Hong Kong Special Administrative Region will retain the status of an international financial centre".
- Hong Kong's economy is undergoing structural change, involving

the financial sector rapidly gaining in relative importance in terms of its contribution to GDP. The "stakes" for sound regulation of monetary and banking matters are therefore high and increasing all the time.

- There is an on-going revolution in the global financial sector, and risk management has a disappointing tendency to lag behind financial innovation and engineering.

- Economic development and reform in China is apparently going to be a bumpy and eventful process, even though the direction is a clear and right one. Given the increasing and close integration of Hong Kong's economy with that of China, the macro-economic environment facing Hong Kong may be less predictable than before.

- There will be substantial changes to the monetary and banking systems in China in the next few years, with significant implications for Hong Kong. It will be necessary to follow such developments closely and respond appropriately in order to safeguard Hong Kong's financial system in accordance with the provisions of the Joint Declaration and the Basic Law.

- International capital flows have become much more volatile and larger in value, and recent changes or expected changes in interest rates and exchange rates make the management of monetary and financial stability a much more complex task.

- The sustained economic boom in Hong Kong and the region in recent years is characterised by negative real interest rates and rising asset prices. There would be pressure on bank profitability and capital adequacy should trends reverse.

#### **PHILOSOPHY OF OPERATIONS**

The above functions and the background against which they are to be performed are clearly formidable for any new institution. In order to meet



this challenge, the Monetary Authority has adopted at the outset the following philosophy of operations:

**Open, fair and transparent**

The Monetary Authority's operations in the money market are conducted openly and announced regularly on market screens. The Monetary Authority frequently briefs the press, interested parties, international specialists and Legislative Council panels on its activities. It will produce a quarterly bulletin, hopefully starting towards the end of 1994. Many of the Monetary Authority's actions are taken only after extensive consultations with the banking community, through the BAC, DTCAC, HKAB, DTCA, HKCMA and other professional bodies.

**Avoid over-regulation**

The Monetary Authority will endeavour to provide a level playing field, with a clear regulatory framework that avoids imposing a burden on the private sector that would inhibit private sector initiative, innovation and enterprise. At the same time, the Monetary Authority will ensure that where laws and regulations do exist, they are strictly enforced to prevent abuses and activities that jeopardise Hong Kong's reputation as a sound international financial centre.

**Innovative and professional approach, matching highest international standards**

Hong Kong can maintain its status as an international financial centre if it develops its financial infrastructure, including clearing and settlement systems, in a way that matches the efficiency and robustness of those of the leading markets. Hong Kong must also offer the whole range of financial instruments that would assist both investors and issuers to deploy their resources and manage their risks in the most efficient manner. The Monetary Authority will work closely with the banking community to ensure that

there is both broadening and deepening of markets in Hong Kong.

Towards this end, the Monetary Authority will develop itself as an organisation of excellence, commensurate with its role as one of the guardians of the Hong Kong financial system and the Exchange Fund. The Monetary Authority will help to promote training and human resources development in professional and ethical standards for the Monetary Authority's staff and to encourage high standards in the banking community as a whole.

**Accountable**

The Monetary Authority is accountable to the Financial Secretary, who is advised by EFAC, of which the Financial Secretary is ex-officio Chairman. The Exchange Fund is managed by the staff of the Monetary Authority under the guidance of EFAC, whose members are appointed by the Governor of Hong Kong. EFAC comprises leading members of the banking community, accounting profession and economics experts, who meet monthly to provide guidance to the operations of the Monetary Authority. EFAC sets the guidelines under which the Monetary Authority may invest the assets of the Exchange Fund and also advises the Financial Secretary on the annual budget of the Monetary Authority. In effect, EFAC functions much like the board of the Monetary Authority. In addition, the accounts of the Monetary Authority are under a stringent system of continuous audit by a team of auditors from the Director of Audit permanently stationed in the Monetary Authority's premises. The Annual Report will be tabled before the Legislative Council.

**INTERNATIONAL PROFILE**

To enhance Hong Kong's status as an international financial centre in the lead up to 1997 and beyond, the Monetary Authority, as the organisation responsible for central banking functions in Hong Kong, has been strengthening its newly established ties





with other central banks, and the international financial community as a whole. This has several key objectives :

- To improve the Monetary Authority's own understanding of international economic and financial trends necessary for its reserves management function;
- To strengthen ties with key central banks and multilateral agencies to facilitate effective monetary management through international co-operation, given Hong Kong's free and open financial market structure;

- To strengthen ties with international banking supervisors in order to consolidate Hong Kong as a premier financial centre with sound supervision; and

- Through international ties and co-operation, to improve the Monetary Authority's own internal research, policy formulation and implementation capacities. The exchange of ideas and techniques will help keep Hong Kong in the forefront of financial innovation and institutional development.

In 1993, the Monetary Authority participated in the Annual Meetings of



