

**Information Paper for the Legislative Council Panel on Financial Affairs
Meeting on 2 February 2004**

Governance of the Hong Kong Monetary Authority

Introduction

This paper sets out the Hong Kong Monetary Authority's (HKMA) comments on the paper "Points of Concern and Suggestions on the Governance of the HKMA" produced by the Legislative Council Secretariat for the Panel on Financial Affairs meeting on 2 February 2004.

Governance of the HKMA

2. The governance arrangements of the HKMA are set out in detail in the paper "Response to the Research Report of the Legislative Council Secretariat" for the Panel on Financial Affairs meeting on 2 June 2003. The paper also sets out the HKMA's responses to the questions raised by Members in connection with the Research Report.

3. There is general international consensus that, apart from some key principles of good governance for central banks, there is no single pattern of governance that can be applied to all central banks. While there is no one system that fits all, the research carried out by the Bank of International Settlements suggests two broad principles. The first is that a central banking institution should have operational and resource independence to enable it to carry out its responsibilities without political influence. The second is that a central banking institution should be transparent in its operations and accountable to the community.

4. Resource independence is necessary because external control over the availability of resources to the central bank could become a tool for influencing its operations. That is why the majority of central banks have resource independence on top of operational independence. This measure of resource independence is balanced by checks and controls to ensure that the resources available to the central bank are sufficient to enable it to carry out its responsibilities but not excessive.

5. In the case of the HKMA, the annual budget and the annual pay review are carefully scrutinised by the Remuneration and Finance Sub-Committee of the Exchange Fund Advisory Committee (EFAC) before endorsement by EFAC and approval by the Financial Secretary. The Sub-Committee is made up entirely of the non-official, non-banking members of EFAC. The accounts and operations of the HKMA are subject to continuous scrutiny by the Director of Audit, who is appointed by the Chief Executive of the Hong Kong SAR under section 7 of the Exchange Fund Ordinance, and by the HKMA's Internal Audit Division, which operates

independently and reports direct to the Chief Executive of the HKMA. The Audit Sub-Committee of EFAC, which is made up of non-official members, scrutinises the accounts and monitors and makes recommendations on the audits carried out by the Director of Audit and the Internal Audit Division.

6. By international standards, the HKMA maintains a high level of transparency in its operations. Over the years, the HKMA has progressively increased the amount and frequency of disclosure about the operation of the Currency Board system and the accounts of the Exchange Fund. The HKMA has also made available detailed information on the full range of our work and responsibilities through our extensive website and publications, through contacts with the media, through regular briefings to Legislative Council Members and through educational and community programmes. The HKMA's strong record on transparency is well known and widely recognised internationally.

7. The HKMA is accountable to the community through the Financial Secretary, who appoints the Monetary Authority, and through the laws passed by the Legislative Council that set out the Monetary Authority's powers and responsibilities. There is a formal commitment from the Chief Executive of the HKMA to appear before the Panel on Financial Affairs three times a year to brief Members and to answer questions on the HKMA's work. At one of these briefings, usually in May, the HKMA's Annual Report is presented. In addition, staff from the HKMA attend Legislative Council Panel meetings to explain and discuss particular issues, and Committee meetings to assist Members in their scrutiny of draft legislation.

Points of Concern and Suggestions on the Governance of the HKMA

8. Comments on the points of concern and suggestions made by Members as summarised in the paper produced by the Legislative Council Secretariat (LC Paper No. CB(1)595/03-04) are set out below.

Annual Budget

9. It is inherently difficult to compare governance across different institutions, since each institution has its own unique governance arrangements deriving from historical factors, the characteristics of the market in which it operates, and its designated functions.

10. For central banking institutions, there is a general international consensus that resource independence is necessary for reasons explained above, and most central banks have it. Because of Article 113 of the Basic Law, which requires the Exchange Fund to be managed and controlled by the Hong Kong SAR Government, the resource arrangements for the HKMA may differ from those of other central banking institutions. But the present arrangements have, over the past decade, been effective in allowing sufficient flexibility in resource deployment for the HKMA

and providing checks and controls, while ensuring that its operations are free from short-term political influence.

11. This measure of resource independence is balanced by checks and controls. As explained above, the HKMA's annual budget is carefully scrutinised by the EFAC Remuneration and Finance Sub-Committee before endorsement by EFAC and approval by the Financial Secretary. The Sub-Committee is made up entirely of the non-official, non-banking members of EFAC. The accounts of the HKMA are subject to continuous scrutiny by the Director of Audit and by the HKMA's Internal Audit Division. The Audit Sub-Committee of EFAC scrutinises the accounts and monitors and make recommendations on the audits carried out by the Director of Audit and the Internal Audit Division. The HKMA Annual Reports, including the accounts of the Exchange Fund, are presented to the Panel on Financial Affairs every year.

Remuneration for senior staff

12. The EFAC Remuneration and Finance Sub-Committee is responsible for making recommendations to EFAC on the remuneration of HKMA staff, taking into account the findings of independent consultants on pay trends and pay levels in the private sector, and assessments of the performance of the HKMA. The Sub-Committee is made up entirely of the non-official, non-banking members of EFAC, who are independent in their status and approach. The Financial Secretary, with the advice of EFAC, determines remuneration on the basis of the Sub-Committee's recommendations. The HKMA provides secretarial support to the Sub-Committee in the form of organising meetings and taking minutes. The collection and analysis of the relevant data and the drawing up of recommendations are carried out independently by the consultants and the Sub-Committee respectively. HKMA staff take no part in the deliberations of the Sub-Committee and are not present when their pay is discussed.

13. In 2002 the EFAC Remuneration and Finance Sub-Committee considered the application to the HKMA of the recommendations arising from a review conducted by the Hay Group Limited for the Government on the remuneration of senior executives of statutory and other bodies, including the HKMA (the "Hay Report"). Taking into account the advice of independent consultants, the Sub-Committee advised application to the HKMA of the key recommendations, many of which already represented the current practice in the HKMA. These practices include targeting the remuneration levels at the median of the financial sector, applying a variable-to-fixed ratio in the remuneration package, using independent pay consultants to monitor levels and trends of remuneration in the financial sector, designating a committee to deal with remuneration issues, following the levels of disclosure provided for in the Companies Ordinance, and exercising flexibility in deciding the remuneration package of individuals, taking into account their background, capability or performance. The implementation framework was

endorsed by EFAC and approved by the Financial Secretary in December 2002 for implementation in the HKMA annual pay review exercise starting in March 2003.

14. As part of the implementation framework, the HKMA has strengthened the disclosure of the remuneration of senior executives by including the remuneration packages of the Chief Executive level, and the averages of the remuneration packages for Deputy Chief Executive and Executive Director levels. Details are available in the HKMA Annual Report 2002.

15. The remuneration of central bank governors reflects a large number of factors, some economic, some political, and some historical. The characteristics of job markets in different economies vary considerably, reflecting the circumstances of individual markets. It is not helpful to compare the levels of remuneration across different central banking institutions, nor is such a comparison among the recommendations in the Hay Report.

16. The HKMA's remuneration policies are published on its website. They are as follows:

- Pay and conditions of service for HKMA staff are determined by the Financial Secretary on the advice of EFAC and its Remuneration and Finance Sub-Committee having regard to prevailing market rates and practices.
- The HKMA remuneration package is a total cash package with minimal benefits in kind. The HKMA operates a Provident Fund Scheme.
- The HKMA pay package consists of two elements: Fixed Pay, which is payable monthly, and Variable Pay, which may be awarded to individual staff as a lump sum once a year depending on the performance of the staff.
- Pay for HKMA staff is reviewed annually by the Financial Secretary on the advice of EFAC and the EFAC Remuneration and Finance Sub-Committee, taking into account the findings of independent consultants on pay trends and pay levels in the financial sector, and assessments of the performance of the HKMA, and other factors considered appropriate. The performance of individual staff members is taken into account in distributing any approved overall pay awards to staff.

The HKMA's Code of Conduct, which provides guidance to employees on their ethical and legal responsibilities, is also published on the HKMA website.

17. In the appointment of the Monetary Authority, the Financial Secretary is required to act reasonably and bona fide and to take all relevant factors into consideration. Relevant factors to be taken into account by the Financial Secretary would include the appointee's educational qualifications, knowledge and experience, competence, financial soundness, integrity and honesty.

Powers and functions

18. The powers and functions of the Monetary Authority are stipulated in the Exchange Fund Ordinance, the Banking Ordinance and other relevant Ordinances, and are summarised in the Exchange of Letters between the Financial Secretary and the Monetary Authority dated 25 June 2003, which also disclose the delegations made by the Financial Secretary to the Monetary Authority under these Ordinances. The role and functions of the HKMA are generally understood by the public. In many areas of Government activity, it is not possible to identify in advance the specific functions for which resources may need to be deployed to achieve strategic goals in an evolving environment, particularly where crises have to be addressed at short notice. Overseas legislation and other instruments, such as the amended Bank of England Act, the new Central Bank Law of Iceland, and the Maastricht Treaty show a similar tendency to stipulate the strategic goals as opposed to resorting to long descriptive lists of functions.

Hong Kong Monetary Authority
26 January 2004