

Brief for the New Governor

HKSARG Land Fund

Objective

To ensure that the operation of the Land Fund is not inconsistent with the JD 213.

Background

2. We have all along accepted that management of the Land Fund, under a Trust set up by the Chinese side in 1986, is a matter for the Chinese. The Trustees (who are the Chinese representatives on the Land Commission) are empowered by the Trust Deed to direct investment of the Fund, on the advice of an Investment Committee. A more detailed background on the establishment of the Land Fund Trust is at Annex A. Since 1985 some \$28 billion, being the future SARG's share of land premium income, has been distributed to the Land Fund. Overall size (including earnings from investments) of the Fund now estimated to exceed \$34 billion.

Problems

3. We have, since December 1990, discussed the following areas of concern with the Chinese side :

- (a) In permitting investment, the Land Fund Trust Deed appears not to be strictly in compliance with JD 213, which only refers to placement of deposits in Hong Kong incorporated banks. It is desirable to strengthen legality of the Trust Deed;
- (b) Diversification of deposit risks arising from the restriction in JD 213 and the scope for extending deposits to other banks; and
- (c) Prudential management of the Fund's activities having particular regard to the need for proper title and safe custody of Land Fund assets.

Present Position

4. After several rounds of discussions, the Chinese are now prepared to consider an exchange of notes at diplomatic level to confirm the previous Land Commission

agreements on the legality of the Trust Deed. We are considering the detailed terms of a draft Exchange of Notes (copy at Annex B), before deciding how to revert to the Chinese.

[REDACTED]

Constitutional Affairs Branch

May 1992

Background to the Establishment of the
Hong Kong Special Administrative Region Government
Land Fund Trust

JD 213 provides that "the Hong Kong Special Administrative Region Government's share of the premium income shall be deposited in banks incorporated in Hong Kong and shall not be drawn on except for the financing of land development and public works in Hong Kong" This provision refers only to the depositing of the premium income but is silent on how the money should be handled thereafter. So far as can be ascertained, the two sides did not address during the negotiations the question of investment (i.e. beyond the mere depositing of the moneys in banks incorporated in Hong Kong).

2. As the future SARG's share of premium income began to accumulate, it was felt in 1986 that it would not serve the best interests of Hong Kong if the Fund's income was forced to remain on deposit with banks incorporated in Hong Kong solely to collect interest, and that the money should be invested prudently to achieve a higher rate of return and in a manner consistent with, and perhaps helpful to,

the maintenance of monetary stability in Hong Kong. It was considered at the time that JD 213 should not prevent funds from being invested provided they were channelled through banks incorporated in Hong Kong.

3. In 1986, the Chinese side set up a trust to administer the HKSARG Land Fund. The Trustees are the three representatives of the Chinese side on the Land Commission : currently Messrs SUN Yanheng (Senior Representative), ZHUANG Weigang and NG Leungsing. We were consulted on the Trust Deed and in order to avoid departure from JD 213, we advised the Chinese side that, in making investments, it should be demonstrated that a "creditor-debtor" relationship would be maintained between the Trustees of the Land Fund and the banks designated for holding the deposits of premium income. The Chinese side took this point, and said that they would try to meet it as far as possible. Furthermore, in deference to our advice, the provisions of the Trust Deed relating to the powers of the Trustees to invest have been cast in such a way that the Trustees are empowered to direct investments to be made, rather than to make those investments themselves. It was thus contemplated that the Trustees, acting on the

advice of a separate Investment Committee (see para. 5 below), would direct the bank (or banks) in which the Fund was deposited to make specified investments on behalf of the Trust.

4. It was on this basis that the adoption of procedures contemplated by the Trust Deed was then considered to be broadly within the terms of the JD. It was also on this basis that the document was endorsed by the Land Commission in April 1987 as being in compliance with the terms of JD 213.

5. The Investment Committee referred to in para. 3 above has been set up under Clauses 15 to 25 of the Trust Deed to advise the Trustees on matters relating to the investment of the Land Fund. Members of the Committee are appointed on a personal basis. The Director of Exchange Fund Office, Mr. Joseph YAM, with Executive Council's approval and the endorsement of the Secretary of State, accepted appointment by the HKSARG Land Fund Trust as a member of the Investment Committee in 1986 and is still serving on this Committee. Other current members are :

Mr. David K.P. LI Bank of East Asia
(Convenor)

Mr. CHUNG Shuiming Chief Executive of
Land Fund Trust

Mr. NG Leungsing Land Fund Trustee

Mr. Paul Selway-Swift Hongkong Bank

Mr. ZHANG Xueyao Bank of China

Draft Exchange of Notes

UK Embassy Note

The Embassy of the United Kingdom of Great Britain and Northern Ireland in the People's Republic of China has the honour to refer to Agreed Minute No. 6 and Agreed Minute No. 10 of the Sino-British Land Commission and the Declaration of Trust annexed to Agreed Minute No. 10 and confirms that the United Kingdom Government understands :

- (a) that both Agreed Minutes and the Declaration of Trust provide for procedures for the handling of the Hong Kong Special Administrative Region Government's share of land premium income and that such procedures are in accordance with Annex III to the Sino-British Joint Declaration on the Question of Hong Kong; and
- (b) that the two sides in the Sino-British Land Commission will continue to co-operate to ensure that the Hong Kong Special Administrative Region Government's share of

land premium income will be handled in accordance with Annex III to the Sino-British Joint Declaration on the Question of Hong Kong.

The United Kingdom Government requests the confirmation of the Chinese Government that it shares the understanding of the United Kingdom Government.

MFA Note

The Ministry of Foreign Affairs of the People's Republic of China acknowledges receipt of the Note [dated] of the Embassy of the United Kingdom of Great Britain and Northern Ireland in the People's Republic of China concerning Agreed Minutes No. 6 and No. 10 of the Sino-British Land Commission and the Declaration of Trust annexed to Agreed Minute No. 10 and concerning co-operation of the two sides in the Sino-British Land Commission and has the honour to confirm that the Government of the People's Republic of China shares the understanding of the United Kingdom Government.