<u>Annex 1</u>

<u>Details of the Operation of the Current Fare Adjustment Mechanisms of the MTR and Franchised Buses</u>

<u>Details of the MTR Fare Adjustment Mechanism (FAM)</u>

Before the Rail Merger in 2007, MTRCL had enjoyed fare autonomy no matter before or after it was listed in 2000.

At the time of Rail Merger in 2007, upon deliberations at the LegCo and approval at the shareholders' meeting of the MTRCL, fare autonomy was replaced by fare adjustment by a direct-drive formula. The arrangement has become more objective and transparent. Currently, the annual Overall Fare Adjustment Rate is calculated according to the following direct-drive formula:

Overall Fare Adjustment Rate

= (0.5 × change in the CCPI in December of the previous year)

+ (0.5 × change in the Nominal Wage Index (Transportation Section) in December of the previous year)

– Productivity Factor (value set at 0% before 2013 and at 0.1% from 2013 onwards)

According to the outcome of the review announced in 2013, the Productivity Factor value in the formula was <u>improved</u> from 0.1% to 0.6%. The enhanced Productivity Factor value can in effect moderate any fare increase by 0.5 percentage point each year from 2013 to 2017, benefitting all MTR passengers.

After the review, there is also an "**Affordability Cap**" in FAM, where no matter the outcome of the direct-drive formula, the fare increase rate of that year will not be higher than the change in the Hong Kong Median Monthly Household Income for the corresponding period to address public affordability.

Moreover, under the "**Profit Sharing Mechanism**", the MTRCL will, based on its underlying business profits each year, set aside an amount to provide fare concessions and share the Corporation's operational success with passengers as well as relieve their burden from fare increase. The underlying business profits include profits from all businesses of MTRCL. Those from property developments and overseas businesses are also included. At the same time, according to the "**Service Performance Arrangement**", an amount will be set aside for serious service disruptions (defined as disruptions of 31 minutes or above) caused by factors within MTRCL's control. The amount will be given back to passengers through fare concessions.

Another deliverable of the review is that **monthly passes and related concessions have been comprehensively enhanced** to address the need and affordability of frequent medium- and long-distance passengers. MTRCL launched a number of new ticket schemes, including–

(i) a new "MTR City Saver" for frequent medium- and long-distance MTR travellers commuting within the urban area (passengers are entitled to 40 MTR rides within 30 days among designated stations in the urban area);

(ii) "Monthly Pass Extras" which offer additional 25% fare discount for onward domestic journeys reaching stations not covered by the particular monthly pass benefitting passengers riding on different railway lines; and

(iii) a new "Tung Chung – Nam Cheong Monthly Pass Extra" in response to passengers' need.

Details of the Fare Adjustment Arrangement for Franchised Buses

The fare adjustment arrangement for franchised buses is a mechanism for the Government to process applications for fare adjustment from franchised bus operators. Before the 1990s, bus operation was subject to profit control. If the profit in a certain year was projected to fall short of the pre-determined rate of return (15% or 16% on the average net fixed assets ("ANFA")), the franchised bus company could on this basis apply for a fare increase. The Executive Council would mainly consider the changes in costs and expenditure before making a decision on the application. Profit control was abolished in the mid 1990s. Thereafter, the Government introduced in 2000 an arrangement comprising a basket of five factors[1]. Meanwhile, if the rate of return exceeds a certain

[1] The five factors were –

(a) changes in operating costs and revenue since the last fare adjustment;
(b) forecasts of future costs, revenue and return;
(c) the need to provide the operator with a reasonable rate of return;
(d) public acceptability and affordability; and
(e) quality and quantity of service provided.

percentage of the rate of return on ANFA[2], part of the profit would have to be shared with passengers on an equal basis. Subsequently in 2006, a formula was added to the basket of factors, thereby increasing the numbers of factors to six.

At present, the basket of factors comprises –

(a) outcome of a fare adjustment formula. The formula is (0.5 × Change in Nominal Wage Index for the Transportation Section) + (0.5 × Change in CCPI) - (0.5 × Productivity Gain));

(b) changes in operating costs and revenue since the last fare adjustment;

(c) forecasts of future costs, revenue and return;

(d) the need to provide the bus operator with a reasonable rate of return;

(e) public acceptability and affordability; and

(f) quality and quantity of service provided.

It should be noted that the formula does not operate as an automatic determinant of the fare adjustment outcome. In processing an application for fare increase, due consideration will be given to the six factors mentioned above.

The Government applies the fare adjustment formula on a quarterly basis. If the formula outcome reaches -2% (equivalent to about a $0.1 difference), the Government will proactively initiate a fare review. The formula outcome and all other relevant factors as mentioned above will be taken into account in doing so.

There is also a passenger reward arrangement under the fare adjustment arrangement. At present, the arrangement will be triggered when the rate of return on ANFA for the bus company reaches or exceeds the threshold of 9.7%. The bus company will then have to share the profit above the threshold as fare concessions with the passengers on an equal basis. Specifically, the bus company will need to use any amount in the passenger reward balance exceeding the equivalent of 1% of the annual revenue for provision of fare concessions within 12 months since the disclosure of the passenger reward balance accumulated.

---

[2] Set at 13% in 2000 and 9.7% from 2006 onwards.