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18 May 2005

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Clerk to the Bills Committee
Hong Kong Special Administrative Region
of the People's Republic of China
Legislative Council
Legislative Council Building
8 Jackson Road, Central
Hong Kong

Attention: Ms. Rosalind Ma

Dear Sir:

Re: Securities and Futures (Amendment) Bill 2005

There are no doubt many arguments that can be made in favour and against separating the roles and responsibilities of the chairman and CEO of the SFC. At the end of the day the critical question is whether the separation of the roles of chairman and CEO will improve the internal governance structure and the market's perception of the SFC as an effective and independent regulator that regulates in firm but fair manner.

As a former Vice Chairman and Executive Director of the SFC, I care about the credibility of the SFC in the financial community. My concern is whether that credibility can be sustained over the long term if SFC staff perform rule-making, investigative, prosecutorial and adjudicative functions. I detect increasing skepticism in the financial community that the existing "checks and balances" are adequate to the task of ensuring fair and impartial adjudication and appropriate oversight of staff by the SFC's governing body.

It is helpful to compare the proposal in the Bill with the position in other jurisdictions. However, in doing so, it is too simplistic to simply ask whether the roles and responsibilities of the Chairman and CEO are split in overseas regulatory bodies.

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It is important to dig deeper and to understand:

- (1) the respective role and responsibilities of staff and the commission (or governing body of the regulator); and
- (2) the composition of the governing body in the context of its responsibility to oversee the work of the agency.

Attached hereto are some very brief point-form comparisons of the Hong Kong SFC with regulators in the U.S., Canada and Dubai. (The Dubai Financial Services Authority is a regulatory agency established in 2004 to international standards under the leadership of Ian Hay Davison (the author of the Securities Industry Report recommending the establishment of the SFC) with the assistance of Robert Owen, the first SFC Chairman). (*Appendix A*)

The conclusions that one can draw from these very brief comparisons are:

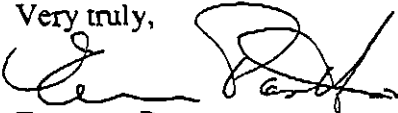
- (1) SFC staff have greater powers to investigate, prosecute and adjudicate than staff of these other regulatory bodies;
- (2) the governing body of the SFC has a more limited role in exercising disciplinary or enforcement powers than the governing bodies of the other regulators; and
- (3) SFC executives form a significantly greater proportion of the governing body than do executive staff elsewhere.

In summary, SFC staff have greater powers to investigate, prosecute and adjudicate while non-executive directors play a more limited role and represent a smaller portion of the governing body. The latter point suggests to me that it would be more difficult for SFC non-executive directors to be an effective "check and balance" than it would be for non-executive directors in the U.S., Canada and Dubai.

In conclusion, splitting the roles of chairman and CEO would be a significant step towards enhancing the role of non-executive directors and the ability of the SFC's governing body to supervise the work of the SFC.

I would be happy to answer any questions which members may have.

The views expressed herein are my own and do not necessarily reflect the views of Troutman Sanders or any other firm with which I am associated.

Very truly,

 Ermanno Pascutto
 Senior Advisor

Encl. - *Appendix A*

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APPENDIX A TO LETTER OF 18 MAY 2005

HONG KONG

Composition of Governing Body

Commission	-	Chairman and CEO
	-	5 Executive Directors
	-	7 Non-Executive Directors
<i>Note: 6 of 13 directors are executives</i>		

SFC Staff	-	The Chairman and 5 Executive Directors also members of the Commission. (Currently one of the positions is vacant.)
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Supervision of SFC Staff by Commission

- Is the board of the SFC optimally structured to perform its function of supervising SFC staff in performance of the SFC's regulatory functions? With an executive Chairman and 5 Executive Directors (who report to the Chairman) on the board, is it difficult for the board to effectively supervise staff of the SFC?

Disciplinary Matters

- The Commission essentially plays no role in disciplinary matters.
- Staff initiate investigations by issuing investigation orders, staff conduct investigations, staff prosecute licensed persons and others and staff adjudicate (e.g. make decisions to discipline licensed persons including suspension and revocation of licence).

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CANADA

Composition of Governing Body

Commission - Chairman is also CEO
- 2 Executive Vice Chairmen
- 10 Non-Executive Commissioners
Note: 3 of 13 members of the Commission are executives.

Staff - The Chairman and 2 Vice Chairmen are full time but the Vice Chairmen have no operating responsibilities. No other OSC full time employee is also a member or director of the Commission.

Supervision of OSC

- Commission supervision of staff is reliant on the executive Chairman assisted by 2 full time Vice Chairmen. The division heads report to the Chairman / CEO. The Commission is comprised of 3 executives and 10 non-executives.

Disciplinary Matters

- Adjudication on disciplinary matters is by the Commission not staff. A typical panel of the Commission consists of 1 Vice Chairman plus 2 Non-Executive commissioners although more commissioners sit on important hearings.
- A quorum of 2 commissioners is required to issue investigation orders i.e. staff may only undertake formal investigations with the consent of 2 commissioners. Staff prosecutes cases before a Commission panel or the courts. Staff do not adjudicate on matters investigated or prosecuted by OSC staff.

Note

- Market participants in Canada have expressed concern about the “perception” of bias given that the Commission investigates, prosecutes and adjudicates. Practitioners are concerned even though (1) the adjudication is by a panel of a minimum of 3 commissioners who have had no prior involvement in the matters and (2) the investigation is authorized by 2 commissioners who do not sit on any subsequent hearing. The Government has proposed to replace Commission adjudication with adjudication by an independent tribunal to dispel market concern about “perception” of bias with the Commission adjudication of decisions of its staff. See www.osc.gov.on.ca/Regulation/FiveYearReview/fyr_20040818_fairness-committee.pdf.

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U.S.

Composition of Governing Body

Commission - Chairman is also CEO
- 4 Non-Executive Commissioners
Note: 1 of 5 members of the Commission is executive.

SFC Staff - No division heads are members of the Commission

Supervision of SEC

- Four of five Commissioners are non-executive and the Commissioners are appointed by the President with 2 appointees from the party not in power (i.e. currently 3 Republicans and 2 Democrats).
- The U.S. Congress is also very active in supervising the SEC.

Disciplinary Matters

- Staff are responsible for investigation and prosecution (subject to the Commission approval of staff recommendations for prosecutions).
- The Commission approves action before an independent hearing officer (usually an administrative law judge). Staff do not adjudicate on disciplinary cases.

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DUBAI

Composition of Governing Body

Board	-	Non-Executive Chairman
	-	CEO
	-	10 non-executive Board members

Note: Of 12 members, only 1 executive sits on the board of the Dubai Financial Services Authority ("DFSA").

SFC Staff	-	The CEO is the only member of the DFSA board. No division heads are members of the Board
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Disciplinary Matters

- Investigations are initiated and undertaken by staff.
- Adjudication (e.g. suspension or revocation of licence) is by staff. There is an appeal to the Regulatory Appeals Committee, an independent committee of the DFSA.

Note

- The DFSA is a recently established financial services regulator and 2 key players in its establishment were Ian Hay Davison the author of the Securities Industry Report (also known as the Davison Report) (1988) which recommended the establishment of the SFC and Robert Owen, the first SFC Chairman.