

7 December 2004

Hon Mr. Bernard Chan
Chairman of the Panel on Financial Affairs
Legislative Council
Hong Kong SAR

Dear Bernard,

Your letter of 24 November 2004 asked for views from the academia on the Securities and Futures (Amendment) Bill 2004. The Bill seeks to enhance corporate governance of the Securities and Futures Commission (SFC) by separating the roles and responsibilities of the chairman from that of the executive arm. The proposal contains two major items:

- (1). to create a new post of Chief Executive Officer (CEO) which would handle day-to-day running of the SFC; and
- (2). to change the existing post of chairman to non-executive status and to stipulate that the non-executive chairman will be precluded responsible from day-to-day regulatory work of the SFC.

I would like to share my thoughts on certain aspects of the Bill, although I will not be able to present these views at the meeting to be held on Monday, 3 January 2005.

I am under the impression that the Administration proposes the current legislative changes in an attempt to bring the SFC in line with “good” corporate governance practice. According to the current conventional wisdom, it is “good” corporate governance practice to split the functions and the posts of chairman and CEO. Proponents argue that this arrangement would create “clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision.” (Cadbury Report 4.9).

The Administration’s proposal stipulates that the chairman should be “non-executive”. Members of the SFC have concerns about the appropriateness of a non-executive chairman. I share their concerns and would like to bring additional views on that matter.

The Administration proposes to create a non-executive chairman at the SFC. It should be noted that the term “non-executive” has well-defined meaning that is prevalent in the academia as well as the business world. In the context of corporate governance, the term “non-executive” refers to those individuals who are not current and/or past employees of the organization. Thus, the non-executive directors (NED) are those directors who are non-employee of the firm. Typically these individuals are part-timers because they have regular full-time positions in other organizations and usually devote

far less than 40 hours a week to the directorship. Indeed, the SFC currently has seven members on its board who are deemed to have “non-executive” status with respect to this classic definition. In fact, the SFC calls these non-executive directors. If the new post a non-executive chairman were to be created, it would seem natural to question how the Administration prepares to define (or for that matter redefine) the “non-executive” status. Would the non-executive chairman be a non-employee as well as a part-timer? Or would the non-executive chairman be a non-employee but is required to devote full-time to the chairmanship of the SFC?

If the non-executive chairman is a non-employee then it would appear that all past and/or current members of the SFC will be precluded from the list of potential candidates for chairmanship at the SFC. It is plausible that a strong non-executive chairman who is neither a past nor a current employee of the SFC would bring additional independence and greater separation of power to the Commission. However, before he/she becomes a strong force on the board, a non-executive chairman would have a steep learning curve to overcome due to its outside status. The duration of the transition period would depend not only on the caliber of the person but also the time he/she is required to devote to the job. In this regard, if the chairman is to be selected from the pool outside of all existing and past SFC members, it would seem appropriate to have the chairmanship be designated as a full-time position.

In its response to SFC (Annex B), the Administration has made clear that “a non-executive chairman is not the same as a part-time chairman.” The Administration also noted that the chairman should “spend as much time as needed to fulfill the role and responsibilities.” However, the Administration did not make clear whether the chairman would be part-time or full-time. Issues handled by the SFC are complex and ever-changing. If the chairman were to provide effective oversight of the organization he/she must have deep knowledge of the organization as well as those complex and ever-changing issues that the organization deals with on a daily basis. Under this consideration, it would also seem appropriate to provide a full-time status to the chairmanship of the SFC.

Yours sincerely,

Chun-Keung Hoi (Stan)