



SECURITIES AND FUTURES COMMISSION 證券及期貨事務監察委員會

8th Floor, Chater House, 8 Connaught Road Central, Hong Kong

香港中環干諾道中八號渣打大廈八樓

12 January 2005

By Courier

Mr. Philippe Richard
 Secretary General
 International Organization of Securities Commissions
 C/ Oquendo 12
 28006 Madrid
 Spain

Dear Philippe,

Hong Kong Securities and Futures Commission (SFC)

I refer to the letter addressed to you dated 8 January 2005 from Ms. Edna Wong, Principal Assistant Secretary for Financial Services and the Treasury (Financial Services), Government of the Hong Kong Special Administrative Region. The letter relates to the Government's proposal of converting the chairman post of the SFC into a non-executive position which maintains overall responsibility of the organization, whilst leaving the day-to-day operational matters to an executive team to be headed by a chief executive officer.

You have been provided by a paper prepared by the Administration for the legislature in Hong Kong. For completeness, I attach the following materials which set out the SFC's views on the proposal:

- (a) SFC's letter to the Administration dated 26 October 2004;
- (b) SFC's written submission to the Legislative Council Panel on Financial Affairs (FA Panel) dated 17 December 2004 [*paragraphs 21 and 22]; and
- (c) SFC Press Release attaching an Opening Statement made by Mr. Andrew Sheng, SFC Chairman, at the FA Panel on 3 January 2005 [*paragraphs 17 & 18].

These materials were previously submitted by the SFC to the legislature and are already in the public domain. For your ease of reference, I have highlighted above the paragraphs (as asterisked) in which the SFC has made reference to IOSCO matters.

If you need any further information, please do not hesitate to let us know.

Yours sincerely,


 Doris Pak
 Commission Secretary

cc Ms. Edna Wong of FSTB (by fax – without enclosures)

DPnc/051010



SFC PRESS RELEASE

3 January 2005

TO THE BUSINESS EDITOR
FOR IMMEDIATE RELEASE

LegCo FA Panel Meeting on Proposal to Split the Post of SFC Chairman

SFC Chairman, Mr Andrew Sheng, attended the meeting of LegCo Panel on Financial Affairs (FA Panel) this morning to share with the Honourable Members his personal views on the Government's proposal of splitting the post of the SFC Chairman into a non-executive chairman post and a chief executive officer post.

An Opening Statement made by Mr Sheng at the FA Panel is attached for your reference.

Ends

For enquiries, please contact C K Chan at 2842 7624 or Ernest Lau 2840 9470.

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Legislative Council Panel on Financial Affairs
3 January 2005

Statement by Andrew Sheng,
Chairman,
Securities and Futures Commission

Re: Agenda V – Proposed amendments to the Securities & Futures Ordinance (“SFO”) – the proposal of splitting the post of the chairman of the SFC into a chairman post and a chief executive officer post

Mr. Chairman,
Honourable Members,

1. First of all, I would like to wish all members Happy New Year.
2. I am also honoured to be invited to provide my views to the Honourable members on the Administration’s proposal to change the SFC’s governance structure.
3. The position of the Commission has already been set out in our written submission to Panel dated 17 December 2004. The Board, namely, both the Executive and Non-Executive Directors, agree in principle that the job of the Chairman could be split between that of the Chairman and a chief executive officer (“CEO”).
4. At the previous Panel in November, the Secretary for Financial Services said that inviting Commission staff to give views to the Panel may present conflicts of interest. I wish to declare that I have no interest in being appointed either as a non-executive Chairman or CEO of the Commission after my contract ends in September this year. I have therefore no personal interest in the outcome of this proposal. However, having served the Commission for seven years by September, I feel that it may be useful to share my personal views on the role of the Chairman of the Commission.
5. I fully agree with the Commission that we support the splitting of the job of the Chairman and the CEO, because the current job is heavy and covers both domestic and international responsibilities. This is because, as we all know, the capital market is one of the pillars of our economy, Hong Kong being the second largest

equity capital raiser in the world in 2004. As all the submissions recognize, the standing of the Commission plays a crucial role in its credibility and ability to oversee one of the most important capital markets in the world, particularly its current vital role for capital formation in the Mainland of China.

6. The key issues being debated today are the independence of the Commission, its accountability for effectiveness and fairness as a statutory regulator and whether there are sufficient checks and balances to ensure that the Commission functions fairly and transparently. The nature of the job of the management of the Commission follows from the above factors. Allow me to elaborate.
7. First, the independence of the Commission as a statutory regulator is crucial to its credibility. I agree therefore with the Administration's Panel paper dated 4 November 2004, which says, "the Government's role is to ensure that the SFC has the necessary statutory powers to carry out its statutory objectives effectively and independently, and that its powers are checked by sufficient safeguards set out clearly in the legislation. We avoid any act that would, or be perceived to, undermine the independence of the Commission."
8. The independence is crucial because the Commission, in carrying out its statutory regulatory functions, should be, and be seen to be, free from political or commercial interests. The success of Hong Kong as a free market depends on free and fair markets. Hence, it cannot be over-emphasized that our successful capital markets should not be embroiled in politics. Attempts to do that by any party can only harm the long-term interests of Hong Kong.
9. The second issue is whether the powers of the Commission are checked by sufficient safeguards set out in the legislation. On this particular point, the Commission's Paper (Paragraphs 11 to 15) already sets out clearly the numerous checks and balances on the regulatory and other functions and powers of the Commission. The Commission is the only securities regulator in the world that is subject to an independent Process Review Panel scrutiny in addition to the independent Securities and Futures Appeal Tribunal review of its regulatory decisions.
10. Despite all these well-functioning checks and balances, this Panel would recall that an Honourable Member asked the Administration in July last year whether the job of the Chairman should be split to reduce the concentration of power in a single individual. To allay any misunderstandings, I believe it is

important for Honourable Members, in evaluating the proposal before you, to appreciate that the powers of the Commission are not concentrated in the Chairman. Following the recommendations of the Hay Davison Report of 1988, the Chairman is explicitly appointed an Executive Chairman in the Securities and Futures Commission Ordinance. But it should be clearly understood that the executive powers of the Commission, especially the regulatory powers, are delegated to individual executive directors, but not the Chairman, whose functions are to be responsible for the Board and act as the public and accountable face of the Commission.

11. Unlike a listed company, the Chairman does not appoint other Executive Directors since all Board members are appointed by the Chief Executive, after a thorough selection process. The terms and conditions of the Executive Directors are also determined by the Chief Executive upon the recommendations of the Financial Secretary and the Remuneration Committee of the Commission, which is chaired by an NED and all its members are NEDs.
12. What does an accountable public face mean? In a listed company, the chairman can easily be part-time and accountable to the shareholders. However, the Commission is a regulatory body and it must be accountable to the public for public and statutory regulatory decisions.
13. I personally believe that I can delegate authority, but not delegate responsibility. I cannot speak for others, but if I am to delegate authority and accept responsibility, I have to devote 100% of my time to understand the daily complex regulatory issues that the Commission is involved in, from licensing, dual filing, hedge funds, to tough enforcement decisions.
14. It should be appreciated that it would be difficult in practice, if not impossible, to separate policy from individual regulatory decisions that can have huge implications for future cases. My experience tells me that the Chairman cannot function effectively and be responsible for policy without some hands-on understanding of the regulatory details of individual cases. This does not mean that the Chairman has to be involved in every individual case, since efficiency and due process would be affected. As an Executive Director, the Chairman has the right to make sure that all due process, checks and balances are followed in individual cases, and that such processes and due fairness are followed in accordance with set procedures, which are reviewed independently by the Process Review Panel. Where the Chairman (or indeed any ED or NED) feels that processes or procedures can

be improved upon or re-examined, following suggestions from the public or the Process Review Panel, the Chairman can request that the policy be reviewed, or that additional legal or expert opinion be sought.

15. Accordingly, it would be difficult in practice to have the situation whereby, as suggested in the Government's 4 November Panel Paper (Para 8), "the non-executive chairman will not be involved in day-to-day regulatory work".
16. In other words, we cannot say that the CEO is responsible for day-to-day decisions and the Chairman is not responsible. For full accountability, there can be only one captain in one ship and during financial crises, as Hong Kong is familiar with, there should be no doubt as to who is fully responsible and accountable for overseeing that crisis in the securities markets.
17. Finally, there is an important international dimension to be considered. Hong Kong's status as an international financial center with well-respected regulatory institutions, has been confirmed in that two Chairs, including myself, have been invited to chair the Technical Committee of IOSCO, the international organization for securities commissions.
18. For the information of Members, the fifteen members of the Technical Committee are responsible for the leading securities markets in the world, accounting for overseeing over US\$25 trillion of stock market capitalization. Within Asia, only Hong Kong, Australia and Japan are members of the Technical Committee, which is the standard setting body. As far as I am aware, all Chairmen of members of the Technical Committee are executive chairmen. Of course, some emerging markets have non-executive directors as chair. There would therefore be a risk for Hong Kong, if the Commission is denied the opportunity of future Chairs of important positions in the international community, because some full-time chairs may not consider a part-time Chair as an equal.
19. The status of the SFC in the international community is an important factor in strengthening Hong Kong's role as an international financial center.

Concluding remarks

20. To conclude, I agree that there should be a Chairman supported by a CEO. For example, the CSRC has a Chairman, supported by an Executive Vice Chairman. Given a choice, my personal view is

that the chairman should be executive and the fully accountable public face of the Commission. Let me say that the Commission fully recognizes that the decision regarding the split between the Chairman and CEO is a policy decision that is a prerogative of the Administration. However, I feel that the Administration and this Panel should carefully weigh all the relevant factors and long-term implications before taking this important policy decision.

21. Thank you for giving the opportunity to present my views.

Securities and Futures Commission
3 January 2005