

**The Legislative Council Panel on Financial Affairs**

**Further discussion on proposed amendments to the Securities and Futures Ordinance - the proposal of splitting the post of the Chairman of Securities and Futures Commission into a non-executive chairman post and a chief executive officer post**

**Purpose**

Further to the discussions at the Legislative Council (LegCo) Panel on Financial Affairs (FA) on 10 November 2004 and 3 January 2005, this paper sets out the Administration's response to the issues raised during previous meetings, as well as the Administration's plan on the way forward.

**Submissions to Legislative Council**

2. The Government's proposal for splitting the post of the Chairman of the Securities and Futures Commission has received clear support from professional bodies including the Hong Kong Institute of Certified Public Accountants, the Law Society of Hong Kong and the Hong Kong Institute of Directors, academics as well as from associations representing the securities and fund management industry. On the other hand, we note that there were two submissions which did not agree to the split, and the Administration has been requested to address the issues raised by these submissions. During the two FA Panel discussions, LegCo members have also raised some issues on which they would like to have further information from the Administration. The following paragraphs highlight these issues and the Administration's response -

<b>Issues</b>	<b>Administration's response</b>
(a) Should the future SFC chairman post be executive or non-executive ?	<p>The Government considers that the future SFC Chairman post should be non-executive –</p> <p>(i) so that he can focus on matters relating to the overall directions, policies and strategies of the SFC having regard to the international and local developments as well as on enhancing the effectiveness of the governing body without being pre-occupied by day-to-day executive responsibilities;</p>

Issues	Administration's response
	<p>(ii) so that he could be independent from the executive arm and hence enhance the internal checks and balances mechanism; and</p> <p>(iii) to avoid overlapping of responsibilities between the chairman and the CEO.</p> <ul style="list-style-type: none"> <li>• The Hong Kong Institute of Certified Public Accountants advocated that the roles of chairman and chief executive of <b>public bodies</b> should be separated, and ideally the chairman should be an independent non-executive member.</li> <li>• Many other public bodies in Hong Kong such as Hospital Authority, Airport Authority, MTRC, KCRC, are also led by non-executive chairmen. Actual experience shows that this governing structure operates effectively and smoothly in public bodies.</li> </ul>
(b) Part-time or full-time	<ul style="list-style-type: none"> <li>• It is not meaningful to label the non-executive chairman as part-time or full-time. A chairman with commitment will spend as much time as necessary to fulfill his/ her roles and responsibilities. There are numerous actual examples of non-executive chairmen of statutory bodies in the past and at present who devote a lot of his time and efforts to their work in performing their duties as the non-executive chairmen in the spirit of providing a service to the community.</li> </ul>

Issues	Administration's response
(c) Is the operating structure of non-executive chairman applicable to a regulator ?	<ul style="list-style-type: none"> <li>• The split model is working well in some other existing financial regulators in Hong Kong, such as the Hong Kong Exchanges and Clearing Limited and the Mandatory Provident Fund Schemes Authority.</li> <li>• Regulatory bodies in the U.K., Sweden and Singapore have also implemented the split for better governance. It has been pointed out at the last Panel meeting on 3 January 2005 that in the U.K., the calls for split of post were made as early as 1999<sup>1</sup>.</li> </ul>
(d) Role and duties  (i) Non-executive Chairman	<ul style="list-style-type: none"> <li>• The chairman's role is to lead the board in setting the overall direction, policies and strategies of the SFC having regard to local and international developments, and in monitoring the performance of the executive arm in fulfilling the objectives set by the board.</li> <li>• The chairman should focus on the following responsibilities – <ul style="list-style-type: none"> <li>(a) enhancing the effectiveness of the governing body;</li> <li>(b) setting agenda and establishing priorities;</li> <li>(c) facilitating effective contributions of non-executive directors (NEDs); and</li> <li>(d) representing the SFC publicly, in liaison</li> </ul> </li> </ul>

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<sup>1</sup> U.K. Joint Committee on Financial Services and Markets – First Report (1999).

Issues	Administration's response
	<p>with local and international financial institutions and other stakeholders.</p> <ul style="list-style-type: none"> <li>The SFC governing body should in the end be responsible for drawing up the details of the duties of and division of responsibilities between the chairman and the CEO, setting them out in writing, and ensuring that they are followed. A proposed division of responsibilities, with reference to those proposed by the Hong Kong Institute of Certified Public Accountants and the actual division of responsibilities in the Financial Services Authority of the U.K., is at <b><u>Annex A</u></b> for reference.</li> </ul>
(ii) Chief Executive Officer (CEO)	<ul style="list-style-type: none"> <li>The CEO should have the executive responsibility on the day-to-day running of the SFC. He should implement the strategy agreed by the SFC governing body, and facilitate the effective functioning of the governing body.</li> </ul>
(e) Appointment and selection criteria  (i) Chairman	<ul style="list-style-type: none"> <li>The present appointment system to continue. The Administration attaches great importance to good governance, effective functioning and credibility of SFC as these are essential to maintaining Hong Kong's reputation as an international financial centre. The Government would be very careful in choosing the most suitable candidate on merit.</li> <li><b>Essential qualities of the candidate include integrity; commitment to serve the community; knowledge of the local and international financial markets; vision and leadership; ability to communicate with the</b></li> </ul>

Issues	Administration's response
	<p>public and the relevant stakeholders and to establish a rapport with relevant bodies in other jurisdictions.</p> <ul style="list-style-type: none"> <li>• We are also keenly aware that appointments to public bodies are subject to intense public scrutiny.</li> </ul>
(ii)CEO	<ul style="list-style-type: none"> <li>• Recruitment of CEO would be conducted through worldwide search. Candidates for the post of CEO should possess solid executive and management ability and experience in order to implement the policy agenda set by the governing body of the Commission. He/she should have hands-on experience and knowledge of the financial markets and the regulatory and compliance issues involved. He/she should also be a good team leader, particularly as a motivator of staff.</li> </ul>
(f) Remuneration  (i) Chairman	<ul style="list-style-type: none"> <li>• In considering the level of remuneration for the new non-executive Chairman post, the following factors will be taken into account – <ul style="list-style-type: none"> <li>(a) It is a service for the community, not employment with the SFC;</li> <li>(b) relativity with the current remuneration of non-executive chairmen of other statutory / public bodies in Hong Kong and relevant regulatory bodies overseas;</li> <li>(c) relativity with the remuneration level for NEDs of SFC;</li> <li>(d) qualifications and experience of the candidate; and</li> <li>(e) whether the candidate is required to resign</li> </ul> </li> </ul>

Issues	Administration's response
	<p>from substantive employment in order to take up the appointment.</p> <ul style="list-style-type: none"> <li>• The actual level of remuneration would have to be negotiated after we have identified the suitable candidate.</li> <li>• Members may wish to note that, at the time when the UK Government started to search for candidates for the new FSA Chairman post in May 2003, the remuneration level for the new post has not yet been decided.</li> </ul>
(ii)CEO	<ul style="list-style-type: none"> <li>• In drawing up the remuneration packages for the future CEO, the existing principles governing remuneration for senior executives as recommended in the Hay Consultancy Report<sup>2</sup> would apply.</li> </ul>
(g) Why similar changes are not proposed for other regulatory bodies in the financial services sector such as the Hong Kong Monetary Authority and the Insurance Authority?	<p><b><u>Hong Kong Monetary Authority (HKMA)</u></b></p> <ul style="list-style-type: none"> <li>• The governance of HKMA has previously been deliberated at the LegCo Financial Affairs Panel<sup>3</sup>. The Exchange Fund Ordinance stipulates that the Monetary Authority (MA) is to assist the Financial Secretary (FS) in the performance of his functions under the Ordinance and to perform such other functions as are assigned by other Ordinances or by the FS.</li> <li>• FS's control of the Exchange Fund is exercised</li> </ul>

<sup>2</sup> In January 2002, the Hay Group was appointed by the Government to conduct a consultancy study on the remuneration of senior executives of 11 selected statutory and other bodies, including the SFC. The study findings were made public in June 2002. The guidelines and practices include: targetting the remuneration levels at the median of the financial sector, applying a variable-to-fixed ratio in the remuneration package, using independent pay consultants to monitor levels and trends of remuneration etc.

<sup>3</sup> LC Paper No. CB(1)847/03-04(05) prepared by the Administration for the Financial Affairs Panel meeting on 2 February 2004.

Issues	Administration's response
	<p>in consultation with the Exchange Fund Advisory Committee (EFAC), of which he is the chairman. EFAC advises the FS on matters relating to the governance of the HKMA, including the terms and conditions of service of staff and the annual administrative budget.</p> <ul style="list-style-type: none"> <li>• The roles and functions of the MA are set out clearly in the Exchange Fund Ordinance, the Banking Ordinance and other relevant Ordinances, and are summarized in the Exchange of Letters between the FS and the MA dated 25 June 2003, which also disclose the delegations made by the FS to the MA under these Ordinances.</li> </ul> <p><b><u>Insurance Authority (IA)</u></b></p> <ul style="list-style-type: none"> <li>• In the light of the international regulatory trends and developments of the insurance industry, the Government has reviewed the institutional set-up of the IA, and has consulted LegCo and the industry on the proposal. We are considering the responses and developing a detailed proposal for the establishment of an independent IA. Our aim is to develop this detailed proposal for further consultation with relevant stakeholders in the next 12 months.</li> <li>• In working out the governance structure for any independent Insurance Authority, due consideration will be given to comparable governance structure of financial services regulators in Hong Kong and insurance regulators in other jurisdictions.</li> </ul>
(h) IOSCO's views on the governance structure of	<ul style="list-style-type: none"> <li>• IOSCO has endorsed in 1998 a comprehensive set of "Objectives and Principles of Securities Regulations (IOSCO Principles)", which set</li> </ul>

Issues	Administration's response
regulatory bodies of the securities and futures industry	out desirable attributes of a regulator <sup>4</sup> . There is no specific discussion on the merits of an executive vis-à-vis a non-executive chairman, but the principles are broad enough to cover different governance structure of a regulator.
(i) Can a non-executive chairman of a member jurisdiction serve as the chairman of IOSCO's Technical Committee?	<ul style="list-style-type: none"> <li>Based on the response from the Secretary General of IOSCO (<b>Annex B</b>), the appointment of the IOSCO Technical Committee chairman is “a <b>personal appointment</b> based on the recognized experience and authority of the appointee” in providing strong input to the work of the organization.</li> </ul>
<p>(j) Other issues</p> <p>(i) Is Chairman of UK FSA executive or non-executive?</p> <p>(ii) Remuneration of Chairman and CEO of UK FSA</p>	<ul style="list-style-type: none"> <li>According to UK FSA's public statement on the detailed division of responsibilities between the Chairman and the CEO, it is stated that “the Chairman has no executive responsibility for the day-to-day running of the FSA” (<b>Annex C</b>).</li> <li>Regarding the remuneration of the Chairman and CEO of UK FSA, the figures quoted by the Administration referred to the <b>actual total remuneration</b> of the Chairman and CEO in 2003/04 as both assumed present positions on 22 September 2003. The figures quoted by the Law Society referred to the <b>base salaries</b> of both the Chairman and CEO <b>per annum</b> (without taking into account their other benefits towards the total package). A detailed</li> </ul>

<sup>4</sup> The principles include: clearly and objectively stated responsibilities; operational independence and accountability; adequate powers, proper resources and capacity to perform its functions and exercise its powers; clear and consistent regulatory process, highest professional standards observed by staff of regulator.

Issues	Administration's response
	<p>comparison is at <b><u>Annex D</u></b>. Relevant extract of the 2003/04 Annual Report of the UK FSA is at <b><u>Annex E</u></b>. In making reference to the remuneration of the UK FSA Chairman, we have to bear in mind that the UK FSA is responsible for not only the regulation of the securities and futures industry, but also that of the banking and insurance industries.</p>

### Conclusion

3. SFC plays very important role in ensuring and reinforcing Hong Kong's position as an international financial centre. Therefore, the Government attaches great importance to the governance of the SFC. Our proposal aims at enhancing the governance of the SFC in order to ensure its effective functioning to meet the challenges of the future and to keep in line with best local and international practice. In selecting the SFC chairman, the Government would be very careful in choosing the most suitable candidate based on merit, taking into account the candidate's integrity, commitment to serve the community, and knowledge of the local and international financial markets. We are keenly aware that the Chairman should be, and be perceived as, independent from external influence so as to preserve the integrity, reputation and image of the independent regulator under the three-tier regulatory system.

4. In addition, as stated in the Administration's paper for the FA Panel meeting on 10 November 2004, given public expectation on the independence of the post of Chairman/SFC, it is our policy intention that during the tenure of the office of Chairman/SFC, he or she should not -

- (a) be a director of any listed company in Hong Kong; or
- (b) have any material interest in any principal business activity of or is involved in any material business dealing with a listed company, or any person or institution engaged in activities regulated by the SFC.

These requirements would be included in the letter of appointment of the new non-executive SFC Chairman.

## **Way forward**

5. The Administration plans to introduce a Securities and Futures (Amendment) Bill in the 2004/05 legislative session to allow for the implementation of the proposed changes.

Financial Services Branch  
Financial Services and the Treasury Bureau  
7 February 2005

**Role and responsibilities of the Chairman of SFC**

1. The Chairman has no executive responsibility for the day-to-day running of the SFC.
2. His/her key responsibilities are to -
  - (a) establish and develop an effective governing body;
  - (b) lead the Board as a team;
  - (c) plan and manage the Board's business;
  - (d) set agenda and establish priorities for SFC;
  - (e) facilitate effective contribution of non-executive directors (NEDs);
  - (f) maintain and develop a productive relationship with the CEO of SFC, for whose recruitment he/she is responsible.
  - (g) ensure that key issues are discussed by the board in a timely manner, that the board has adequate support and is provided with all the necessary information on which to base decisions;
  - (h) ensure that the SFC communicates effectively with its stakeholders; and
  - (i) represent the SFC publicly, in liaison with local and international financial institutions and other stakeholders.

**Role and responsibilities of the CEO of SFC**

1. The CEO should have the executive responsibility on the day-to-day running of the SFC. He should implement the strategy agreed by the SFC governing body, and facilitate the effective functioning of the governing body. The key responsibilities include -

- (a) reporting to the governing body regularly with appropriate, timely and quality information;
- (b) informing and consulting the chairman on all matters of significance to the SFC;
- (c) developing and delivering the strategic objectives agreed with the governing body; and
- (d) overseeing the day-to-day regulatory work of the Commission and ensuring that the Commission is equipped with the necessary staffing, financial and risk management systems for its mission.



OICV - IOSCO

## **Annex B**

Organización Internacional de Comisiones de Valores  
International Organisation of Securities Commissions  
Organisation internationale des commissions de valeurs  
Organizaçào Internacional das Comissões de Valores

12 January 2005

Ms. Edna Wong  
Principal Assistant Secretary for Financial Services  
and the Treasury (Financial Services)  
Government of the Hong Kong Special  
Administrative Region  
18<sup>th</sup> Floor  
Admiralty Centre Tower 1  
18 Harcourt Road  
Hong Kong

**Subject: Proposed Legislative Changes Concerning the Hong Kong Securities and Futures Commission Governance**

Dear Ms. Wong,

We have received your letter dated 8 January 2005 concerning the above mentioned subject.

IOSCO has endorsed in 1998 a comprehensive set of *Objectives and Principles of Securities Regulation* (IOSCO Principles) and has encouraged all its members to implement them in their respective jurisdictions. The IOSCO Principles are sufficiently broad to be adapted to all existing domestic contexts and, in particular, provide some flexibility with respect to the governance structure of securities regulators.

Each IOSCO member is responsible for designating the persons who act as its representatives during IOSCO meetings, including the person who acts as head of its delegation. Other IOSCO members obviously assess the level and authority of these representatives and take decisions, in part based on this assessment. The international credibility of an IOSCO member regulator is no doubt related to that of its representatives and to their ability and authority to provide strong input to the critical work undertaken within the Organization.

The appointment of the IOSCO Technical Committee Chairman is a personal appointment based on the recognized experience and authority of the appointee. Mr. Andrew Sheng is the current Chairman of the Technical Committee. Should Mr. Sheng resign his current position as Chairman of the Hong Kong Securities and Futures Commission, the members of the Technical Committee would need to appoint a new Technical Committee Chairman.

Sincerely yours,

Philippe Richard  
Secretary General

Calle Oquendo 12  
28006 Madrid  
ESPAÑA  
Tel.: (34.91) 417.55.49 • Fax: (34.91)  
555.93.68  
mail@oicv.iosco.org • www.iosco.org

1. The Chairman has no executive responsibility for the day-to-day running of the FSA.
2. His key responsibilities are to:
  - i. establish and develop an effective Board;
  - ii. lead the Board as a team;
  - iii. plan and manage the Board's business;
  - iv. establish priorities for the FSA;
  - v. maintain and develop a productive relationship with the FSA Chief Executive, for whose recruitment he is responsible;
  - vi. with the Chief Executive, lead the communication of FSA policies with a wide range of constituencies. One purpose of this communication programme is to establish a clearer profile for the FSA, rather than one of an individual;
  - vii. represent the FSA on particular national and international financial institutions;
  - viii. establish and maintain high level contacts with the most important financial institutions worldwide;
  - ix. act as an accountability focus for the FSA, chairing its annual public meeting, giving evidence to select committees, and writing to the Chancellor (if needed) on the most significant issues arising under the formal exchange of letters of December 2000; and
  - x. represent the FSA in the most senior meetings of the Tripartite Standing Committee, alongside the Chancellor and Governor.
3. The Chairman discharges his responsibilities by ensuring:
  - i. the effectiveness of the Board in relation to (insofar as the Treasury can be influenced) the balance of Board appointments; the responsibilities, chairmanship and effectiveness of Board committees; the agenda for Board meetings; the relationship between executive and non-executive Board members; and the provision of appropriate, quality and timely information for directors;
  - ii. that the FSA's strategy is formulated clearly and is well understood internally and externally;
  - iii. that he provides a source of counsel and of challenge to the Chief Executive on how the FSA is run. This includes feedback to the Chief Executive on senior management performance, development and succession, and on organisational structure;
  - iv. regular evaluation of the performance of the Board, its committees and individual directors; and
  - v. that he is properly briefed on FSA business to enable him to discharge his duties as Chairman, and to represent the FSA publicly. The Chairman has an unlimited right to consult any FSA employee, require information on any aspect of FSA business, and attend any executive meeting within the FSA. He will not normally chair any executive committee.

4. The Chairman and Chief Executive will discuss all major issues and emerging policies through frequent and normally informal meetings.
5. The Company Secretary will report to the Chairman.
6. The Chairman will chair the Appointments Committee of the Board.
7. The Chairman will represent the FSA on the Court of the Bank of England, CESR and the Financial Stability Forum.

## **Role of the Chief Executive**

1. The Chief Executive is responsible for implementing the strategy agreed by the Board, in whose formulation he will have played a major part. He has the executive responsibility for the FSA's business under authority delegated to him by the FSA Board.
2. The key responsibilities of the Chief Executive are:
  - i. reporting regularly to the Board with appropriate, timely and quality information so the Board can discharge its responsibilities effectively
  - ii. informing and consulting the Chairman on all matters of significance to the Board so that the Chairman and Board can properly discharge their responsibilities;
  - iii. developing and delivering the strategic objectives agreed with the Board;
  - iv. recommending to the Board significant operational changes and major capital expenditures where these are beyond his delegated authority;
  - v. assigning responsibilities clearly to senior management and overseeing the establishment of effective risk management and control systems;
  - vi. recruiting, developing and retaining talented people to work at the FSA; and in particular establishing a strong management team which is fairly and fully evaluated;
  - vii. communicating throughout the FSA the strategic objectives and the values of the FSA agreed with the Board, and ensuring that these are achieved in practice;
  - viii. sharing with the Chairman and with other members of the FSA senior management the responsibility for communicating the FSA's messages externally;
  - ix. represent the FSA on selected international financial institutions.
3. All FSA staff, other than the Chairman's immediate staff and the Company Secretary, report to the Chief Executive.

**Comparison of the remuneration level of chairman and CEO of UK  
FSA<sup>1</sup>**

<i>Figures in £</i>	Base salary (per annum)	Other benefits	Bonus	Total Package per annum	Actual payment 2003/04 <sup>2</sup>	in
Chairman	314,000	64,638	0 <sup>3</sup>	378,638 (approx)	223,769 <sup>4</sup>	
CEO	365,000	108,685	52,000	525,685 (approx)	471,656 <sup>5</sup>	

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<sup>1</sup> Source: UK FSA press release dated 30 June 2004

<sup>2</sup> Both Chairman and CEO assumed present position on 22 September 2003.

<sup>3</sup> The Chairman does not participate in the performance-related bonus scheme.

<sup>4</sup> Comprises salary at 159,131 pounds and other benefits valued at 64,638 pounds.

<sup>5</sup> Comprises salary at 310,971 pounds, other benefits valued at 108,685 pounds, and bonus at 52,000 pounds.

**Extract from the 2003/04  
Annual Report of UK FSA**

This section of the Report contains audited information.

Directors' emoluments comprise:

	Board fee	Salary	Performance related bonuses	Other emoluments and benefits	2004 Total	2003 Total
	£	£	£	£	£	£
<b>Executive Directors</b>						
Howard Davies (Chairman until 21.9.03) <sup>1,3</sup>	-	154,933	-	38,073	193,006	397,287
Callum McCarthy (Chairman from 22.9.03)	-	159,131	-	64,638	223,769	-
Michael Foot <sup>3</sup>	-	262,500	39,000	44,675	346,175	322,017
Carol Sergeant	-	235,577	-	18,770	254,347	293,452
John Tiner <sup>2</sup>	-	310,971	52,000	108,685	471,656	361,904
<b>Non-executive Directors<sup>4</sup></b>						
Stewart Boyd (Deputy Chairman) <sup>5</sup>	45,000	-	-	-	45,000	45,000
Moira Black <sup>6</sup>	23,750	-	-	-	23,750	27,500
James Crosby	4,308	-	-	-	4,308	-
Tom De Swaan	20,000	-	-	-	20,000	20,000
Kyra Hazou	20,000	-	-	-	20,000	20,000
Deirdre Hutton	20,000	-	-	-	20,000	20,000
Sir Andrew Large <sup>7</sup>	-	-	-	-	-	-
Gillian Nott	20,000	-	-	-	20,000	20,000
Christopher Rodrigues <sup>8</sup>	13,846	-	-	-	13,846	20,000
Dr Shamit Sagar	20,000	-	-	-	20,000	20,000
Stephen Thieke	20,000	-	-	-	20,000	8,333
Sir Keith Whitson <sup>8</sup>	3,333	-	-	-	3,333	20,000
Clive Wilkinson <sup>6</sup>	23,750	-	-	-	23,750	20,000
	233,987	1,123,112	91,000	274,841	1,722,940	1,615,493
Of which fees for service as						
Directors	-	-	-	-	233,987	240,833
Remuneration as executives					1,488,953	1,374,660
					1,722,940	1,615,493

- Howard Davies resigned as Chairman on 21 September 2003. The figure for other emoluments and benefits paid during the year includes £20,000 for the provision of advice during a three-month transitional period.
- The total emoluments of the highest paid director during the year, John Tiner, were £471,656 (2003: £361,904), including a supplement of £47,741 (2003: £58,140), paid during the year towards the funding of his personal pension.
- The prior year totals have been restated to include a revised estimate of the proportion of the costs of the car and driver with which the directors were provided.
- The fee for a non-executive director was set by the independent panel, established with the approval of HMT, at £20,000 per annum with effect from 1 December 2001. An additional fee of £5,000 per annum is paid to any non-executive director (other than the Deputy Chairman) who has been appointed to chair a committee of the Board. There were none in this category during the year, as the Deputy Chairman or the Chairman chaired all relevant committees. Otherwise, the fee covers all duties as directors.
- The fee payable to the Deputy Chairman was set by the independent panel at £45,000 per annum with effect from 1 December 2001.
- Two directors chaired the Board of the FSA Pension Plan Trustee Ltd in the year; Moira Black from 1 April 2003 to 30 September 2003, and Clive Wilkinson from 1 October 2003 to 31 March 2004. The annual fee was set at £7,500 with effect from 1 April 2002 and was pro-rated between each director.
- Sir Andrew Large waived his Board fee in respect of the year.
- The fees for James Crosby (HBOS), Christopher Rodrigues (Bradford and Bingley plc) and Sir Keith Whitson (HSBC Holdings plc) were paid direct to their employers, as shown in brackets. Christopher Rodrigues and Sir Keith Whitson retired during the year and their fees were pro-rated. James Crosby's fee is paid to charity by HBOS.