

23 December 2004

The Hon Mr Bernard CHAN  
Chairman  
Panel on Financial Affairs  
Legislative Council of the Hong Kong SAR  
8 Jackson Road C

***BY ORDINARY MAIL***

Dear Mr Chan

***SECURITIES AND FUTURES (AMENDMENT) BILL 2004***

Thank you for your letter of 24 November 2004 inviting me to provide my views on the above matter. I do apologise for the delay in submitting my response and hope that the comments raised herein will be given due consideration by the members of your panel.

The thrust of the proposal as set out by the Administration in LC Paper No CB(1)177/04-05(01) is to have the Securities and Futures Commission (“SFC”) led by a non-executive chairman with a chief executive officer in charge of its executive arm.

I am ***NOT*** in favour of the proposed amendment for the reasons as summarized in the ensuing paragraphs:

1. In my opinion the Administration fails to make a case as to why the SFC warrants closer scrutiny of its governance structure while the regulators of the banking and insurance industries do not despite their importance as pillars of the financial system in Hong Kong. Although this proposal is premised on the grounds of improving the governance structure of the SFC the Administration does not allude to any specific incident(s) to support its implicit view that the existing structure is wanting save for stating that “the SFC should set exemplary standards for others to follow.” Furthermore unlike the other public bodies to which the proposal refers namely the Airport Authority, the Kowloon Canton Railway Corporation and the Mass Transit Railway Corporation, the SFC is in the ‘business’ of regulating markets. Even ignoring the problems that have plagued the other public bodies at various times the Administration does not adequately explain how a presumably part-time non-executive chairman can effectively discharge the duties that are expected of such an office.

2. The local and international best governance practice as referred to by the Administration in formulating its current proposal is most appropriate for widely held public listed companies. In fact so specific are some of the requirements including that for independent non-executive directors that these are not 'scalable' even for certain entities such as private and/or not for profit companies. In short it would be both difficult and impractical to implement these 'best governance practices' across the board for the type of companies as mentioned above let alone to impose them upon a statutory regulator as the SFC which role and objectives are clearly set out in the *Securities and Futures Ordinance*. The full appreciation of this important distinction should lead the Administration to realise that there are critical inadequacies in its benchmarking.
3. Save for the Financial Services Authority ("FSA") in the United Kingdom none of the established markets have split the office of chairman in the manner as proposed by the Administration. To the best of my knowledge this matter has not even been considered by the International Organisation of Securities Commissions which may be adduced as evidence of a widely held perception that the present structure works adequately. I would venture to suggest that the proposal by the Administration goes even further than that as adopted by the FSA since it expects 'the financial implications to the SFC as a result of the creation of a CEO post would be minimal'. The Chairman of the FSA draws a substantial salary and the separation of the office has increased its costs by the equivalent of at least one full time director.
4. The SFC is already subject to a number of checks and balances from both within and without. It has established a number of committees that comprise of and are chaired by non-executive directors. The roles and functions of these committees are reported in a transparent manner in the annual report of the SFC. The SFC is also subject to a number of external safeguards which include the Process Review Panel and the Securities and Futures Tribunal. In addition the SFC is not immune to the judicial process as its decisions are subject to judicial review. In my opinion the Administration has failed to address the crucial question of how an 'independent' chairman can improve upon the effectiveness of the safeguards as outlined above especially since all of the directors of the SFC are appointed and may be removed by the Chief Executive of the HKSAR under the provisions of the *Securities and Futures Ordinance*.

The SFC has been relatively successful in enhancing its reputation as an independent regulator under the able stewardship of four different chairmen since its establishment in May 1989. At this juncture there exists no tangible evidence that its governance structure is lacking nor has the Administration offered any explanation as to why the SFC warrants closer scrutiny than the Hong Kong Monetary Authority (“HKMA”) or the Office of the Commissioner of Insurance (“OCI”) neither of which has a board of directors although the activities for which they have regulatory oversight are no less important. While it may be argued that there are structural and organisational differences between the SFC, the HKMA and the OCI these must certainly pertain more to form rather than substance and it is the latter that has to be properly addressed.

The proposal by the Administration carries with it the potential for far reaching adverse consequences for the SFC if handled ineptly. The speed at which the Administration is seeking to implement this amendment may expose it to the type of oversight that was evident in the recent deferment of the listing of the Link REIT on the Stock Exchange of Hong Kong. I am of the opinion that neither the authority nor the reputation of the SFC should be subject to such a risk and would accordingly urge your panel to exercise prudence in considering this proposal by the Administration.

Last but not least while on the issue of governance I take the liberty of enclosing herewith two articles that I published recently for favour of comments by members of your panel and would be happy to discuss the contents in more detail at a mutually convenient time:

- a. **A Framework for the Delisting of Penny Stocks in Hong Kong** (2004) Vol 30 No 1 *North Carolina Journal of International Law & Commercial Regulation* 75
- b. **Self Certification of Independence of Directors: Some Preliminary Thoughts** (2004) Vol 7 No 2 *Corporate Governance International* 30

With warm wishes for a truly merry Christmas and a wonderful new year

Yours sincerely

LOW Chee Keong  
Associate Professor in Corporate Law

Encs

Remarks:

The following two articles provided by Professor LOW Chee-keong are not enclosed:

- (a) A Framework for the Delisting of Penny Stocks in Hong Kong;  
and
- (b) Self-Certification of Independence by Directors: Some Preliminary Thoughts.

Members of the Panel on Financial Affairs who are interested to have sight of the two articles may contact Ms May LEUNG at 2869 9132.

Annex

A copy of this document is kept at the Legislative Council Library.  
Please contact the Legislative Council Library if you wish to refer to this document.