

Corporate Governance and the SFC

We always strive to enhance our corporate governance, accountability and transparency by adopting and implementing appropriate best practice. During the year, we changed the composition of the Audit Committee and Remuneration Committee so that they only comprise Non-Executive Directors. We believe this will strengthen our system of checks and balances. We published the number of meetings of our Board and internal committees and the average attendance rate of Directors in our last Annual Report. To further enhance transparency, we have published the attendance rates of individual Directors in this Report (see discussion below). We will monitor closely the global development in corporate governance and review the relevance of recommended best practices to us as a regulator.

10

In this chapter, we will discuss:

- The accountability of the Commission
- Independent and external reviews
- Internal oversight committees
- Internal control reviews
- Public redress mechanism
- Our performance pledges

The Commission

The HKSAR Chief Executive appoints our Directors and determines their remuneration packages. Presently, the Commission has 11 Directors – five full-time Executive Directors including the Chairman and six independent Non-Executive Directors. We are conducting a recruitment exercise for a Chief Operating Officer to fill an Executive Director position which has been left vacant since 1 March 2001. Since the SFO requires that the majority of the members of the Commission shall be Non-Executive Directors, an additional Non-Executive Director may be appointed later.

All important policies and decisions are discussed and approved by the Commission. In addition, our operational departments regularly brief the Directors on the latest developments in the industry and the market. The Commission receives minutes of internal committees on a regular basis. This practice facilitates the Commission in monitoring the performance of the management.

Commission meetings are held regularly every month, with additional sessions when necessary. Other Committee meetings are scheduled so that as many members as possible (which must include the Chairman or Deputy Chairman of the Committee) can attend. Inevitably, some members could not attend some of the meetings because of conflicting schedules. They were informed of the agenda and given the discussion papers, and might provide comments. Members were also kept informed of the discussions during the meeting by way of minutes.

Last year, the Commission met 14 times, with an average 79% attendance of Directors.

Number of meetings	14	
Attendance of individual Directors		
Andrew L T Sheng	10	71%
Ashley Alder	13	93%
Mark Dickens	11	79%
Alexa Lam	12	86%
Alan Linning	12	86%
Henry H L Fan	12	86%
Daniel R Fung	11	79%
Raymond P L Kwok	10	71%
T Brian Stevenson	11	79%
Jasper Tsang Yok Sing	11	79%
Anna H Y Wu	8	57%
Average attendance of meetings	79%	

The Commission reports regularly to the Financial Secretary and the Legislative Council (LegCo). By law, our annual report must be submitted to the Financial Secretary and laid before LegCo.

As a public body, the Commission is mindful of its duty to manage its fiscal affairs prudently. The Commission submits its annual estimates of income and expenditure to the HKSAR Chief Executive, who has delegated the authority for approval to the Financial Secretary. The Commission must seek prior approval of the Financial Secretary for expenditure which exceeds the approved budget by more than 10%.

Independent and External Reviews

The Commission is regularly monitored and reviewed by external independent bodies. These safeguards ensure that the Commission acts in a fair and equitable manner and follows due process.

■ An Independent Review Panel

The Process Review Panel (PRP) is an independent, non-statutory panel established by the HKSAR Chief Executive to review the Commission's internal operating procedures. It reviews whether the Commission has followed its internal procedures, including those for ensuring consistency and fairness.

The PRP comprises 12 members, including nine members from the financial sector, academia and the legal and accountancy professions, and three ex-officio members including the Secretary of Justice (or her representative), the Commission's Chairman and a Non-Executive Director of the Commission.

Over the last year, the PRP reviewed the Commission's procedures by examining various completed cases. These included the following: routine inspection of intermediaries, registration of intermediaries, authorisation of collective investment schemes, the handling of takeovers and mergers transactions and complaints, approval of prospectuses and granting of

exemptions under the Companies Ordinance and the Securities (Disclosure of Interests) Ordinance. The PRP also examined the Commission's procedures for public consultation and those for handling of complaints from the public about the conduct of intermediaries.

The PRP met four times in the past year, in addition to the regular meetings held by the Panel's two working groups. At the meetings, the PRP discussed specific topics in relation to the Commission's internal procedures and various papers containing observations and recommendations of the working groups following their case reviews.

The PRP made invaluable recommendations that cover a wide range of areas relating to specific cases and procedural issues. Most of these recommendations have been accepted by the Commission. The PRP's second annual report has been submitted to the Financial Secretary.

■ Securities and Futures Appeals Panel

The independent Securities and Futures Appeals Panel, until its replacement by a new tribunal under the SFO, heard appeals against decisions made by the SFC relating to the registration, regulation and discipline of intermediaries. Appointed by the HKSAR Chief Executive, the Panel was a part-time merits review panel headed by a Senior Counsel, with industry experts as members.

Six appeals were lodged in 2002-2003, of which two have been withdrawn (one in September 2002 and the other in April 2003), one decided by the Panel with our decision varied and three in progress. Of the six appeals, five are in relation to disciplinary decisions made by our Enforcement Division and one about a licensing decision made by our Licensing Department. Three appeals lodged in the previous year were concluded: two were withdrawn and one dismissed with our decision confirmed by the Panel. In the appeal made by Chan Sheung Chi Steven, the Panel upheld the SFC's decision to suspend Chan's registrations with the

SFC for two years for misconduct. Chan was found to have acted in concert with another person in complete disregard of the Code on Takeovers and Mergers and failed to act in accordance with the standards of conduct reasonably expected of a registered person.

The SFO replaces the existing part-time Panel with an independent full-time appeal body, namely the Securities and Futures Appeals Tribunal (SFAT). The Tribunal is chaired by a judge. A wider range of the SFC's decisions will be subject to review by the SFAT; its jurisdiction will also cover appeals from decisions of the SFC and HKMA concerning registered institutions.

■ ICAC Reviews

The Independent Commission Against Corruption (ICAC) has conducted corruption prevention reviews on the procedures of our supporting departments and operational divisions since 1990. After completing the last five reviews in 2001-2002 on the areas of complaints handling, intermediaries registration, intermediaries supervision, investment products authorisation and outsourcing of information technologies services, the ICAC has gone through all our procedures.

Last year, we discussed with the ICAC on its recommendations to improve our control procedures in the five areas to further minimise the chance of abuse and malpractice. We have gradually adopted all the recommendations of the ICAC, where appropriate.

Internal Committees

Our Non-Executive Directors play an important role in ensuring that the Commission is accountable and transparent. They monitor the performance of the Commission by asking questions and considering policies at the Board, and participating in various internal committees.

■ Budget Committee

The terms of reference of the Budget Committee require that the Chairman of the Committee to be a Non-Executive Director; the current chairman is Henry H L Fan. The Budget Committee examines and approves the proposed parameters and basis for annual budget compilation. It also reviews the estimates of our income and expenditure, which will then be submitted to the full Board for approval.

Number of meetings	1	
Attendance of individual Directors		
Henry H L Fan	0	0%
Raymond P L Kwok	1	100%
Mark Dickens	1	100%
Andrew L T Sheng	1	100%
Average attendance of meeting	75%	

■ Audit Committee

The Audit Committee, chaired by T Brian Stevenson, a Non-Executive Director, reviews the annual financial statements before their submission to the Commission for approval. It monitors the Commission's financial situation by receiving quarterly financial reports. In particular, it examines the breakdown of expenditure on legal and professional services, and information and systems services. It also regularly reviews all non-audit related fees paid to the external auditors.

The Audit Committee plays an important role in the selection and appointment of the external auditors and the design of the scope and planning of the external audit. It reviews audit findings set out in the external auditors management letters and management's responses to them, and monitors the subsequent implementation of agreed improvements.

The Audit Committee also plays a role in monitoring our non-financial system. It considers and approves our annual internal control review programme, and monitors the implementation of measures to improve internal control procedures.

2002-2003 was a busy year for the Audit Committee. Last August, the Board asked the Audit Committee to investigate into a series of anonymous complaints alleging malpractices of internal procedures and management in the Commission. The Audit Committee appointed PricewaterhouseCoopers to assist it to conduct an independent investigation. The Audit Committee published the investigation report in February 2003, finding all the allegations not substantiated and making recommendations to improve our human resources policies and procedures.

Number of meetings	8	
Attendance of individual Directors		
T Brian Stevenson	8	100%
Anna H Y Wu	8	100%
Raymond P L Kwok ¹	3	60%
Andrew L T Sheng ²	2	100%
Average attendance of meetings	92%	

- ¹ Mr Kwok has become a member since 19 August 2002. There were five meetings during his term.
- ² Mr Sheng has ceased to be a member since 19 August 2002. There were three meetings during his term and he abstained from one meeting due to conflict of interests.

■ Remuneration Committee

The Remuneration Committee, chaired by Daniel R Fung, a Non-Executive Director, considers and approves the results of the annual pay review by a market consultant and any proposals on changing the compensation structure and pay ranges. The Commission, on the advice of the Remuneration Committee, determines the pay levels and pay awards of our staff. Last year, in view of the prevailing market conditions and our budgetary deficit, the Remuneration Committee decided to freeze our salary and make no awards of performance based variable pay to staff.

Number of meetings	4	
Attendance of individual Directors		
Daniel R Fung	4	100%
Henry H L Fan	3	75%
Raymond P L Kwok ¹	2	100%
Alan Linning ²	N/A	N/A
Andrew L T Sheng ²	2	100%
T Brian Stevenson ¹	2	100%
Jasper Tsang Yok Sing ³	2	67%
Anna H Y Wu ¹	0	0%
Average attendance of meetings	81%	

- ¹ Mr Kwok, Mr Stevenson, and Ms Wu have become members since 18 November 2002. There were two meetings during their term.
- ² Mr Linning and Mr Sheng have ceased to be members since 18 November 2002. There were two meetings during their term. Mr Linning abstained from both meetings due to conflict of interests.
- ³ Mr Tsang has become a member since 15 July 2002 and there were three meetings during his term.

■ Management Committee

In addition to the three committees discussed above, another important internal control mechanism is the Management Committee. The Management Committee comprises all our Executive Directors and Senior Directors and performs administrative, financial and management functions as delegated by the Commission.

At its monthly meetings, the Committee considers funding requests from departments and divisions including requests to engage outside consultants and advisers. It also has the power to determine the remuneration, allowance and conditions of employment. Every month, it reviews the staffing position, financial situation, progress of major information technology projects and latest initiatives.

Internal Control Reviews

At the beginning of each financial year, we submit our plan for internal control reviews to the Audit Committee for approval. The plan includes reviews by outside consultants and our cross-divisional audit teams. The results of the reviews are reported to the Audit Committee to ensure the internal control procedures are observed and enforced. By law, the Director of Audit may examine books, records and other documents kept by the SFC.

■ KPMG

The Audit Committee appointed KPMG during the year to review the payroll and staff benefits procedures, fee collection procedures of the Corporate Finance Division, and fixed assets acquisition and insurance policy. KPMG informed us that the control over these areas was generally satisfactory.

Since KPMG also audits our financial statements, the Audit Committee has proposed that we appoint a different auditor to conduct internal control reviews next year to enhance the independence of the reviews and the objectivity of the external auditor. We will implement this proposal in 2003-2004.

■ Cross-Divisional Audits

To supplement the annual internal control review conducted by KPMG, our cross-divisional audit teams also review different internal procedures every year. Last year, the cross-divisional team of the Corporate Finance Division looked at the revenue control system of the Finance Department. The preparation of the final report is under way.

Public Redress Mechanism

Members of the public can lodge complaints against the Commission and its staff with the Office of the Ombudsman if they believe that the Commission or its staff have been guilty of maladministration in the performance of their functions. In 2002-2003, the Ombudsman received five complaints against the Commission and none against its staff. The Ombudsman found two of the complaints not substantiated; the other three cases are in progress.

In addition to having recourse to the Ombudsman, members of the public who are dissatisfied with the Commission's performance of its functions may take civil action in the Courts against the Commission, by either applying for judicial review of the Commission's decisions or by seeking remedies. There were no judicial reviews last year.

Our Performance Pledges

In discharging our regulatory duties, we pledge to be responsive to the general public, market participants, and intermediaries under our supervision.			% of cases meeting the pledge in 2002-2003
Investor Enquiries	Preliminary response to telephone enquiries	4 working days	100%
	Preliminary response to written enquiries	2 weeks	100%
Public Complaints	Preliminary response to verbal & written complaints	2 weeks	99.4% ¹
General Enquiries	Preliminary response to enquiries via enquiry@hksfc.org.hk	4 working days	99.3% ²
Licensing Applications	Processing of applications from principals	15 Weeks	82.5% ³
	Processing of applications from representatives	10 weeks	94.2% ³
Modification/Waiver and Subordinated Loan Applications	Acknowledgement of receipt upon receiving any application	2 working days	100%
Investment Products Authorisation	Take-up of applications upon receipt	2 working days	100%
	Preliminary response to applicants after take-up for unit trusts, mutual funds and investment-linked assurance schemes	1 week	94.1% ⁴
	Preliminary response to applicants after take-up for other products	2 weeks	90% ⁴

1. Some cases did not meet the pledge due to their complexity. More time was needed to collect information to facilitate preliminary assessment.
2. Figure is based on the 967 enquiries received since 15 May 2002, when the performance pledge was announced. Some cases did not meet the pledge because of the manual processing before the introduction of an automated system in August. Of the 967 enquiries received, full replies within four days were achieved in 911 cases or 94.2%.
3. Cases that did not meet the pledge mainly consisted of those where contentious issues were involved or where there were delays in the provision of required documentation.
4. Some cases did not meet the pledge because they belonged to certain categories of investment products where there was a sudden upsurge in the number of applications.