

Corporate Governance and the SFC

As the statutory regulator of the securities and futures markets in Hong Kong, the Commission places great importance on corporate governance. We always strive to enhance our accountability to the public and the transparency of our work. We adopt and implement corporate governance practices commensurate with the best standards applicable to public bodies.

[In this chapter, we will discuss]

- The composition and operation of the Board
- Commission committees
- Conduct standards
- Internal controls
- Independent checks and balances
- Our performance pledges

The Commission

■ Composition of the Board

The constitution and proceedings of the Board are defined by the SFO. All the Members of the Board are appointed by the HKSAR Chief Executive for a fixed term and the SFO requires that the majority of the Members must be independent Non-Executive Directors (NEDs). The composition of the Board ensures independent supervision of the Commission's executive functions.

The remuneration package of individual Executive Directors (EDs) is determined by the HKSAR Chief Executive upon the recommendation of the Remuneration Committee of the Commission, which is chaired by an NED and comprises only NEDs. Our NEDs receive a fixed sum of honorarium every year.

At the end of the year under review, the Board comprised 12 Members: five full-time EDs including the Chairman and seven NEDs. During

the year, Mr Daniel Fung, Mr Brian Stevenson and Ms Anna Wu stepped down after serving as NEDs of the Commission for six years. Mr Eddy Fong, Mr Kenneth Kwok and Professor Liu Pak Wai joined the Commission as new NEDs for a term of two years. Both Mr Alan Linning and Mrs Alexa Lam were re-appointed EDs while Mr Peter Au-Yang, Chief Operating Officer and ED, has doubled up as ED of Corporate Finance since Mr Ashley Alder left the Commission on 22 October 2004. Mr Mark Dickens, who has served the Commission for 14 years, eight of which as ED, retired on 31 March 2005.

■ How the Commission Operates

All important policies and decisions are discussed and approved by the Board, which meets regularly every month and holds additional meetings as necessary. Divisional staff attend Board meetings to explain policy proposals, report on important operational matters and regulatory issues. Members are also briefed on the financial positions of the Commission and provided with monthly financial statements.

To play an effective oversight role, the Board has delegated most of the regulatory powers and functions to individual EDs, staff or Committees, reserving the critical functions at the Board level. The Commission maintains a detailed delegation list.

All newly appointed Members receive briefings on the work of the Commission and are provided with

relevant SFC documents including a copy of the Code of Conduct, which sets out the legal obligations and the Commission's requirements on them. All Members are required to disclose their investment portfolio upon appointment and report any subsequent changes to the Commission.

Members have separate and independent access to the senior management and divisional staff for additional information they may require about any policy proposal. They have access to the Commission Secretary, who is responsible for ensuring the procedures of the Commission are complied with. Members and the Commission Committees can seek independent professional advice at the expense of the Commission as and when necessary.

Attendance of Directors at Commission Meetings in 2004-2005



Number of meetings	12	
<i>Attendance of individual Directors</i>		
Andrew L T Sheng	10	83%
Ashley Alder	8	100%
Peter Au-Yang	12	100%
Mark Dickens	11	92%
Alexa Lam	12	100%
Alan Linning	10	83%
Christopher W C Cheng	11	92%
Eddy C Fong	3	100%
Daniel R Fung	5	56%
Kenneth H W Kwok	3	100%
Raymond P L Kwok	10	83%
York Liao	8	67%
Liu Pak Wai	2	67%
T Brian Stevenson	7	78%
Jasper Tsang Yok Sing	10	83%
Anna H Y Wu	7	78%
Average attendance of meetings	85%	

The individual attendance rates are based on the respective number of Commission meetings Members were expected to attend during their terms. For details of their terms, please see Chapter on Directors of the Commission.

Commission Committees

The Commission has established the Advisory Committee, Public Shareholders' Group and other consultative and regulatory committees with a largely external membership drawn from the

market. These committees provide external input to the Commission on policy matters.

NEDs play an important role in ensuring that the Commission is accountable and transparent by chairing and participating in various Commission committees, which have their respective terms of reference. The Commission committees circulate their minutes and report important issues to the Board regularly.

The NEDs' role is particularly important in several internal committees:

Audit Committee

The Audit Committee comprises only NEDs. Mr Eddy Fong, a Certified Public Accountant, is the Chairman. Senior staff including EDs are invited to attend meetings where necessary.

The Audit Committee convenes every quarter and additionally if necessary to review quarterly and annual financial statements before their submission to the Commission for approval. It endorses the appointment of external auditors for the Commission's approval every year and plays an important role in the design of the scope of internal and external audits. It reviews audit findings set out in the external auditors' management letters and management's responses to them, and monitors the implementation of agreed improvements.

The Audit Committee also examines management procedures to monitor the effectiveness of the systems of financial and internal control. It considers and approves our annual internal control review programme and cross-divisional audit programme.

For the provision of non-audit services by external auditors, the Audit Committee will critically consider each engagement on a merit basis. To ensure independence and objectivity of the annual audit, two different external auditors are appointed to perform respectively the annual audit and internal control review of the Commission.

Corporate Governance and the SFC

Attendance of Directors at Audit Committee Meetings in 2004-2005



Number of meetings	5	
Attendance of individual Directors		
Eddy C Fong (Chairman)	1	100%
T Brian Stevenson (Chairman)	4	100%
Raymond P L Kwok (Deputy Chairman)	5	100%
Anna H Y Wu (Deputy Chairman)	4	100%
Kenneth H W Kwok	1	100%
Average attendance of meetings	100%	

The individual attendance rates are based on the respective number of meetings Members were expected to attend during their terms in the Audit Committee. For details of their terms, please see Chapter on Directors of the Commission.

Remuneration Committee

The Remuneration Committee, chaired by Dr York Liao, comprises all NEDs. Senior staff are invited to attend the meetings where necessary.

The Remuneration Committee reviews policy on the level and structure of staff remuneration and makes recommendations to the Commission. It also considers and approves results of pay surveys. The Remuneration Committee is consulted on the re-appointment of EDs and decisions on senior management.

The HKSAR Chief Executive and the Financial Secretary under the delegated authority of the former determine the remuneration packages of the SFC Chairman and EDs taking into consideration recommendations by the Remuneration Committee. Details of the EDs' remuneration are on page 78. The pay packages comprise an annual fixed pay and a performance-related variable pay.

The SFC Chairman consults the Remuneration Committee on the payment and amount of variable pay to individual EDs as a matter of good corporate governance practice. The recommendations are reported to the Administration for information.

Attendance of Directors at Remuneration Committee Meetings in 2004-2005



Number of meetings	4	
Attendance of individual Directors		
Daniel R Fung (Chairman)	2	100%
York Liao (Chairman)	3	75%
Christopher W C Cheng (Deputy Chairman)	4	100%
Anna H Y Wu (Deputy Chairman)	2	100%
Eddy C Fong	1	50%
Kenneth H W Kwok	2	100%
Raymond P L Kwok	3	75%
Liu Pak Wai	1	50%
T Brian Stevenson	1	50%
Jasper Tsang Yok Sing	2	50%
Average attendance of meetings	75%	

The individual attendance rates are based on the respective number of meetings Members were expected to attend during their terms in the Remuneration Committee. For details of their terms, please see Chapter on Directors of the Commission.

Budget Committee

The Budget Committee is chaired by NED Mr Raymond Kwok. It examines and approves the proposed parameters and basis for annual budget compilation, including the estimates of our income and expenditure for the next financial year, which will then be submitted to the full Commission for approval.

Attendance of Directors at Budget Committee Meetings in 2004-2005



Number of meeting	1	
Attendance of individual Directors		
Raymond P L Kwok (Chairman)	1	100%
Christopher W C Cheng (Deputy Chairman)	1	100%
Peter Au-Yang	1	100%
Mark Dickens	1	100%
Alexa Lam	N/A	N/A
Liu Pak Wai	N/A	N/A
Andrew L T Sheng	1	100%
Average attendance of meetings	100%	

Mrs Lam and Prof Liu became members on 29 March 2005.

■ Management Committee

The Management Committee comprises all EDs, Senior Directors and the Chief Counsel. It 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 has the power to determine the remuneration, allowance and conditions of employment. Every month, it also reviews the Commission's financial and staffing positions, and progress of major information technology projects.

Conduct Standards

■ Code of Conduct

The Commission requires the highest standards of integrity and conduct from its staff. It sets out in the Code of Conduct its requirements and the relevant legal obligations. In particular, all Commission staff should be aware of potential conflicts of interest and ensure that their work is carried out properly, impartially and free from any suggestion of improper influence. All Commission staff are required to keep confidential information acquired in the course of duties.

The Code sets a clear policy for staff on personal dealings in securities and futures contracts and various statutory requirements relating to personal dealings. The Code requires staff to declare their investment in securities and futures contracts upon commencement of employment and report all subsequent transactions.

During the year, we thoroughly reviewed and updated the Code and provided training to staff on the revised Code and the reporting system.

■ Public Interest Grievances

The Personnel Manual comprises major human resources policies and procedures as approved by the Commission, which include the Equal Employment Opportunities policy, grievances procedures and disciplinary procedures. These procedures ensure that personnel matters are handled in a fair and impartial process with adequate checks and balances.

The Grievance Procedures – Public Interest Grievances is published on our website to assist those who believe that they have discovered improper practices or misconduct relating to the running of the Commission or work related activities of Commission employees, to report these to the Commission in a constructive manner. The procedures enable the following persons to report confidentially: any person who has an employment contract with the Commission, is on secondment to the Commission, is engaged as an independent consultant by the Commission or is a contractor or supplier of services to the Commission.

■ Complaints against Commission Staff

The Commission has a policy of transparency and accountability. It takes seriously any dissatisfaction regarding the way in which Commission staff have carried out or failed to carry out their duties. The Procedures for Handling Complaints against Commission Staff ensures prompt handling of any complaints from members of the public against our staff and facilitates effective follow-up action. We have published the procedures on our website to enhance transparency and provide clear guidance to the public.

Corporate Governance and the SFC

Internal Controls

The internal control procedures ensure that the Commission achieves its regulatory objectives and performs its regulatory functions in a fair and transparent manner and in accordance with the law. In addition, the Commission's operational procedures help safeguard assets against unauthorised use or disposition, maintain proper accounting records and ensure reliability and integrity of information used within the Commission or for publication.

■ Accountability and Transparency

Individual divisions and departments of the Commission follow operating manuals in performing functions and exercising powers. The manuals ensure that we comply with relevant legal, regulatory and administrative requirements. They are subject to review by the independent Process Review Panel.

The Commission is accountable for the use of its financial resources and has established detailed financial and budgetary control procedures. For the reporting and disclosure of the Commission's financial statements, we have adopted the International Financial Reporting Standards promulgated by the International Accounting Standards Board since 2000-2001.

The financial statements are considered by the Audit Committee and approved by the Board before the Chairman and one NED sign them. Each year, the revised and proposed budgets are submitted to the Financial Secretary for approval and laid before the LegCo after consideration by the Commission. By law, the Director of Audit may examine any books, accounts, vouchers, records or documents kept by the Commission.

The Commission has always been fiscally responsible. Despite our expanded functions and workload and the strain on resources, we have always exercised strict controls over our operational expenditure, in particular the personnel expenses. The Performance Comparisons chapter shows that our staff number increase was

significantly less than the increase in our workload over the last 10 years (from 1994-1995 to 2004-2005). The table at the end of this chapter compares our staff complement and costs with our counterparts in Australia, UK, USA and Singapore over the period from 2001-2002 to 2004-2005.

The Commission is committed to open communication with our stakeholders and the public. We publish our Quarterly Reports and Annual Report within 45 days after the end of the relevant period. We report our operations and activities to the public through periodic newsletters, press releases, publications and press conferences. Last year, we revamped our website to enhance transparency and access to information by the public.

■ Internal Audit

As a relatively small organisation, we do not have a full-time internal audit unit. Instead, we have appointed PricewaterhouseCoopers to conduct internal control review for us annually. PWC's review forms part of the Commission's overall annual internal control review programme, which is approved by the Audit Committee and includes also reviews by our cross-divisional audit teams.

The purpose of the internal control review is to assess whether the systems of internal control as set out in the various Commission's manuals are adhered to, to evaluate the adequacy of the controls in place, to safeguard assets and ensure reliability and integrity of information, and to identify enhancements to current procedures and controls to improve operating efficiency. The internal controls are designed to provide reasonable, but not absolute, assurance that errors and irregularities will not occur, and that procedures are performed in accordance with management's intentions.

During the year, PWC reviewed the recruitment process, commitment, expenditure and purchases procedures, travel and entertainment policy and procedures, and investment and banking

procedures. They confirmed that the controls over these areas were generally satisfactory. Their findings and recommendations were reported to the Audit Committee.

The Intermediaries and Investment Products Division conducted a cross-divisional audit on the fees collection procedures of the Corporate Finance Division during the year. The audit report was submitted to the Audit Committee for comment and approval.

■ Risk Management and Contingency Plans

The operational divisions of the Commission closely monitor and assess risks in their respective regulatory areas. They regularly report their risk analysis and make recommendations in managing the risks to the Board. We have a market contingency plan, which details procedures for dealing with emergency situations that may affect Hong Kong's securities and futures markets.

We also have prepared an internal contingency plan to deal with emergency situations that may affect the Commission's operations, such as fire, flooding or other disasters that may affect the Commission's offices. The plan details the contingency measures from all operational and supporting divisions in recovering and resuming their business during and after any emergencies.

Independent Checks and Balances

The Commission is subject to various external checks and balances designed to ensure fairness and observance of due process. These include statutory rights of appeal, judicial review, and scrutiny by independent bodies such as the Process Review Panel, the Ombudsman and the Independent Commission Against Corruption.

■ An Independent Review Panel

The Commission's internal procedures for regulating the markets, including procedures for ensuring consistency and fairness, are reviewed

on an on-going basis by the Process Review Panel (PRP). The PRP is an independent, non-statutory panel established by the HKSAR Chief Executive in November 2000. The Commission is the first securities regulator in the world to introduce such an external review system on its internal operations.

The PRP currently 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 for Justice (or her representative), the Commission's Chairman and an NED of the Commission.

Over the past year, the PRP reviewed the Commission's procedures by examining various completed cases. These included the following: application of licence by intermediaries, registration of intermediaries, registration of Registered Institutions, inspection of intermediaries, prudential visit of intermediaries, authorisation of collective investment schemes, handling of complaints against intermediaries, and investigation and disciplinary action.

■ Securities and Futures Appeals Panel/Tribunal

A wide range of the regulatory decisions of the Commission are subject to a full review by the Securities and Futures Appeals Tribunal (SFAT), which is chaired by a High Court judge and comprises two other members appointed by the HKSAR Chief Executive. There were 20 appeals lodged with the SFAT during the year: five were determined, eight were withdrawn and seven were in progress.

Before the establishment of the SFAT, the independent Securities and Futures Appeals Panel (SFAP) heard appeals against decisions made by the SFC relating to the registration, regulation and discipline of intermediaries. The SFAP heard and decided on the last two appeals before it during the year. The SFC is appealing against the decision of one of the cases.

Corporate Governance and the SFC

■ ICAC Reviews

The Independent Commission Against Corruption (ICAC) has conducted periodic corruption prevention reviews on the procedures and practices of the Commission since 1990. In early 2004, the Government recommended that the Commission invite the ICAC to study its procedures and practices for the performance of listing-related functions from the point of view of corruption prevention and other related issues, such as building in checks and balances in the internal control system. The review was completed in the last quarter of 2004, and we had responded to the ICAC regarding the implementation of its recommendations.

■ Reporting to the Government

The Commission is an independent regulatory body but is subject to regular reporting and furnishing of information to the Financial Secretary and the Financial Services and the Treasury Bureau regarding our operations and important issues. We are required to consult the Financial Secretary before exercising certain powers. After consultation with the Chairman of the Commission, the Chief Executive may, upon being satisfied that it is in the public interest to do so, give the Commission written directions as to the furtherance of any of its regulatory objectives or the performance of any of its functions.

Our Performance Pledges			% of cases meeting the pledge in 2004-2005
In discharging our regulatory duties, we pledge to be responsive to the general public, market participants, and intermediaries under our supervision.			
Investor Enquiries			
■ Preliminary response to telephone enquiries	4 business days		100%
■ Preliminary response to written enquiries	2 weeks		99.8% ¹
General Enquiries			
■ Preliminary response to enquiries via enquiry@sfc.hk	4 business days		100%
Public Complaints			
■ Preliminary response to verbal & written complaints	2 weeks		99.8% ²
Licensing Applications			
Processing of licensing applications			
■ Representatives (provisional licence)	7 business days		91% ³
■ Representatives (normal licence)	8 weeks		80% ³
■ Representatives (responsible officer)	10 weeks		91% ³
■ Corporations	15 weeks		91% ³
■ Change of accreditation	7 business days		82% ³
Modification/Waiver and Subordinated Loan Applications			
■ Acknowledgement of receipt upon receiving any application	2 business days		100%
Investment Products Authorisation			
■ Take-up of applications upon receipt	2 business days		100%
■ Preliminary response to applicants after take-up for unit trusts, mutual funds, investment-linked assurance schemes and MPF pooled investment funds	7 business days		100%
■ Preliminary response to applicants after take-up for other schemes	14 business days		100%

1. Only one case failed to meet the pledge due to the exceptionally heavy workload when the enquiry was received.

2. Two cases failed to meet the pledge due to their complexity. More time was needed to collect information to facilitate assessment.

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 by applicants.

Public Redress Mechanism

Members of the public can complain to the Ombudsman against the Commission and its staff if they believe that we have been guilty of maladministration in the performance of our functions. During the year, the Ombudsman concluded three complaints against the Commission, including one from the year before, and found all three complaints not substantiated.

Anyone who is dissatisfied with a Commission decision may appeal to the SFAT. Where this remedy is not available, they may take civil action in the Courts against the Commission, by either applying for judicial review of the Commission's decisions or seeking remedies. There were three judicial reviews against decisions made by the Commission last year: one was ruled in favour of the Commission, one was withdrawn after settlement and the remaining case is in progress.

Comparison of Regulatory Costs with Overseas Regulatory Agencies



	00/01	01/02	02/03	03/04	04/05	% Change 04/05 over 00/01
Securities & Futures Commission (SFC)						
■ No. of staff (including regular and temporary)	396	415	403	416	431	8.84%
■ Total personnel costs (\$M)	328	314	303	328	356	8.54%
■ Total expenditure (\$M)	421	417	396	423	452	7.36%
US Securities & Exchanges Commission (SEC)						
■ No. of staff	3,285*	3,009	3,149*	3,730*	3,871*	17.84%
■ Total personnel costs (US\$M)	dna	335	413*	546*	585*	74.63%#
■ Total expenditure (US\$M)	427*	487	592*	842*	888*	107.96%
Australian Securities & Investment Commission (ASIC)						
■ No. of staff	1,219	1,221	1,284	1,396	1,531	25.59%
■ Total personnel costs (A\$M)	84	83	85	97	116	38.10%
■ Total expenditure (A\$M)	139	143	160	173	196	41.01%
Financial Services Authority, United Kingdom (FSA)						
■ No. of staff	2,039	2,145	2,273	2,303	dna	12.95%+
■ Total personnel costs (£M)	103	118	129	147	dna	42.72%+
■ Total expenditure (£M)	188	208	218	232	dna	23.40%+
Monetary Authority of Singapore (MAS)						
■ No. of staff	823	870	969	979	dna	18.96%+
■ Total personnel costs (S\$M)	88	105	97	101	dna	14.77%+
■ Total expenditure (S\$M)	116	141	256	351	dna	202.59%+

SFC figures do not include staff and expenditure of Investor Compensation Company Limited, a subsidiary formed in September 2002.

* Budget figures extracted from Congressional Budget Request

% change 04/05 over 01/02

+ % change 03/04 over 00/01

dna Data not available