

Corporate Governance and the SFC

»» As the statutory regulator of the securities and futures markets in Hong Kong, the Commission always strives to enhance our accountability to the public and the transparency of our work by adopting and implementing corporate governance practices appropriate to best standards of public bodies.

This Chapter Is About

- »» **The composition and operations of the Commission**
- »» **Commission committees**
- »» **Internal controls**
- »» **Independent and external reviews**
- »» **Our performance pledges**

The Commission

» Composition

The constitution and proceedings of the Board of the Commission are defined by the SFO. All our Directors are appointed by the HKSAR Chief Executive and the law requires that the majority of our Directors to be independent Non-Executive Directors (NEDs).

The Commission at present comprises 13 Directors — six full-time Executive Directors (EDs) including the Chairman and seven independent NEDs. Our Directors bring to the Commission a balance of skills and experience of different disciplines and professions which benefit the Commission tremendously. The terms and conditions of offices of the Directors and their remuneration are determined by the HKSAR Chief Executive.

During the year, Mr Henry H L Fan stepped down as a NED of the Commission, and Dr York Liao and

Mr Christopher Cheng both joined the Commission as our new NEDs. Mr Peter Au-Yang, an experienced investment banker, was appointed as the Chief Operating Officer and ED with effect from 26 May 2003.

All newly appointed Directors receive briefings on the work and background of the Commission and relevant SFC publications and documents including minutes of the Commission meetings of the recent quarter and schedule of the coming Commission meetings. A copy of the Code of Conduct for Directors and Staff, which sets out the conflicts of interest guidelines and disclosure requirements on investments, is provided to every Director.

All Directors are required to disclose their investments portfolio upon appointment. The Directors and Commission staff are bound by the provisions of the SFO relating to the preservation of secrecy and avoidance of conflicts of interest.

» How the Commission Operates

The Commission meets regularly every month and holds additional meetings as necessary. All important policies and decisions are discussed and approved by the Commission. During Commission meetings, divisional staff explain policy proposals to the Directors and give regular briefings to the Directors on the progress of their work and important policy and operational issues.

The Directors have separate and independent access to the senior management and divisional staff for any additional information they require. All Directors have access to the Commission Secretary who is responsible for ensuring the procedures of the Commission are complied with, and for advising the Directors on compliance issues.

Attendance of Directors at Commission Meetings in 2003-2004		
Number of meetings	12	
Attendance of individual Directors		
Andrew L T Sheng	11	92%
Ashley Alder	12	100%
Peter Au-Yang ¹	10	100%
Mark Dickens	11	92%
Alexa Lam	10	83%
Alan Linning	12	100%
Christopher Cheng ²	4	80%
Henry H L Fan ³	6	86%
Daniel R Fung	9	75%
Raymond P L Kwok	10	83%
York Liao ¹	9	90%
T Brian Stevenson	8	67%
Jasper Tsang Yok Sing	10	83%
Anna H Y Wu	10	83%
Average attendance of meetings	87%	

¹ Mr Au-Yang and Dr Liao have become members since 26 May 2003 and there were 10 meetings during their term.

² Mr Cheng has become a member since 15 November 2003 and there were five meetings during his term.

³ Mr Fan was a member until 14 November 2003 and there were seven meetings during his term.

The Directors are also briefed on the financial positions of the Commission by way of monthly financial statements giving details of the budget, expenditure, revenue and forecasts. Our financial statements are published in the annual reports and quarterly reports to provide a balanced, clear and comprehensive assessment of the Commission's performance. Our financial statements are considered by the Audit Committee and approved by the Board before they are signed by the Chairman and one NED of the Commission. Each year, the revised and proposed budgets are submitted to the Financial Secretary for approval under the delegated authority of the HKSAR Chief Executive and laid before the LegCo after consideration by the Commission.

The Directors and the Commission committees can seek independent professional advice at the expense of the Commission as and when necessary.

The system of delegation and sub-delegation of the Commission's functions including those functions which are non-delegable are defined in the law. The Commission maintains a detailed list of all functions of

the Commission that have been delegated or sub-delegated and the Committees and post-holders to whom such functions have been delegated or sub-delegated.

Commission Committees

The Commission has established the Advisory Committee and a number of regulatory committees in performing its functions. The Advisory Committee provides an external input to the Commission on policy matters. In addition, the Commission often forms ad hoc working groups with representatives from the industry and the market in developing new policy initiatives. The composition and terms of reference of the regulatory committees are on page 131.

Our NEDs play an important role in ensuring that the Commission is accountable and transparent. They chair and participate in various Commission committees. In addition, the Chairman and the COO regularly consult the NEDs on important personnel and risk management matters.

> Audit Committee

The Audit Committee is chaired by Mr T Brian Stevenson, a Chartered Accountant and a NED of the Commission. The composition of the Audit Committee was revised in August 2002 to comprise only NEDs.

The Audit Committee convenes regular meetings at a quarterly interval and additional ones when necessary to review quarterly financial reports and the annual financial statements before their submission to the Commission for approval. It endorses the appointment of external auditors for the Commission's approval on an annual basis 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 subsequent implementation of agreed improvements. For the provision of non-audit services by external auditors, the Audit Committee will critically consider each engagement on a merit basis. The external auditors are also requested to provide a

statement to ensure that the provision of such services does not impair the external auditors' independence or objectivity.

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. At the advice of the Audit Committee to have the internal control review and annual audit conducted by separate professional accounting firms to enhance the independence and objectivity of the review and audit, the Commission appointed last year PricewaterhouseCoopers (PWC) in place of KPMG, which is our external auditors, for conducting the internal control review.

During the year, the Audit Committee also considered the revised Personnel Manual providing additional coverage on the procedures of the equal employment opportunities policy, grievance procedures, disciplinary procedures for handling performance issues and disciplinary procedures for handling conduct issues. With the establishment of the grievance procedures, the Audit Committee will deal with grievances raised by Commission staff, where applicable, about the operations of the Commission. The Commission will report on a quarterly basis to the Audit Committee regarding grievances made to the Commission and decisions taken on them.

During the year, we paid KPMG, our external auditors, \$288,300 for audit-related services and \$148,000 for non-audit related activity involving the IT security review of FinNet. We paid PWC \$151,500 for conducting the annual internal control review.

KPMG was also engaged as the external auditors of a number of funds e.g. compensation funds which are under the supervision of the Commission directly or indirectly as required by the law. In total, they paid KPMG \$237,300 for annual audits and half yearly interim reviews.

Attendance of Directors at Audit Committee Meetings in 2003-2004		
Number of meetings	5	
Attendance of individual Directors		
T Brian Stevenson	5	100%
Anna H Y Wu	5	100%
Raymond P L Kwok	4	80%
Average attendance of meetings	93%	

➤ Remuneration Committee

The Remuneration Committee, chaired by Mr Daniel R Fung, comprises all NEDs.

The Remuneration Committee reviews policy on the level and structure of staff remuneration and makes recommendations in this regard to the Commission. It also considers and approves results of pay surveys. The Remuneration Committee is also consulted on the re-appointment of EDs and decision 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 Directors' remuneration packages are on page 88. 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 decisions are reported to the Administration for information.

The remuneration of the NEDs is determined by the Financial Secretary with delegated authority by the HKSAR Chief Executive.

During the year, the Remuneration Committee discussed the market position of pay levels of the top three tiers of senior executives as well as other staff, re-appointment of EDs, discretionary performance-related variable pay, and the revised Personnel Manual.

Attendance of Directors at Remuneration Committee Meeting in 2003-2004

Number of meeting	1	
Attendance of individual Directors		
Daniel R Fung	1	100%
Henry H L Fan ¹	N/A	N/A
Anna H Y Wu ²	1	100%
Christopher Cheng ³	1	100%
Raymond P L Kwok	1	100%
York Liao ⁴	1	100%
T Brian Stevenson	1	100%
Jasper Tsang Yok Sing	1	100%
Average attendance of meeting	100%	

¹ Mr Fan was the Deputy Chairman of the Remuneration Committee until 14 November 2003 and there was no meeting during his term.

² Ms Wu has become the Deputy Chairman of the Remuneration Committee since 17 November 2003.

³ Mr Cheng has become a member since 15 November 2003.

⁴ Dr Liao has become a member since 26 May 2003.

➤ Budget Committee

The terms of reference of the Budget Committee require that the Chairman and Deputy Chairman to be NEDs; the current chairman is Mr Raymond P L Kwok. The Budget Committee 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 Meeting in 2003-2004

Number of meeting	1	
Attendance of individual Directors		
Henry H L Fan ¹	N/A	N/A
Raymond P L Kwok ²	1	100%
Christopher Cheng ³	1	100%
Peter Au-Yang ⁴	1	100%
Mark Dickens	0	0%
Andrew L T Sheng	1	100%
Average attendance of meeting	80%	

¹ Mr Fan was the Chairman of the Budget Committee until 14 November 2003 and there was no meeting during his term.

² Mr Kwok has become Chairman of the Budget Committee since 17 November 2003.

³ Mr Cheng has become Deputy Chairman of the Budget Committee since 17 November 2003.

⁴ Mr Au-Yang has become a member since 17 November 2003.

➤ Management Committee

The Management Committee comprises our EDs, Senior Directors and the Chief Counsel 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 financial situation, staffing position, progress of major information technology projects and latest initiatives of the Commission.

Internal Controls

Our internal control procedures have been designed for safeguarding our assets against unauthorised use or disposition, maintaining proper accounting records and ensuring reliability and integrity of information used within the Commission or for publication. In addition, internal controls in a broad sense also include the various checks and balances that ensure us achieving our regulatory objectives and performing our regulatory functions in a fair and transparent manner and in accordance with the law and established operational procedures.

As a relatively small organisation, we do not have a full-time internal audit unit. Instead, PWC has been appointed to conduct internal control review for us annually. The annual internal control review programme, which is approved by the Audit Committee, includes reviews by both external consultants as well as our cross-divisional audit teams.

➤ PWC

PWC was appointed in July 2003 as the external consultant to carry out our internal control review programme approved by the Audit Committee. The purpose of the review is to assess whether the systems of internal control as set out in the various

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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 fee collection procedures, application approval and revocation procedures of the Investment Products Department and the Licensing Department and procedures of appointing external professional consultants. They confirmed that the controls over these areas were generally satisfactory. Their findings and recommendations were reported to the Audit Committee.

➤ Cross Divisional Audit

The cross-divisional audit programme is designed to supplement the annual internal control review programme conducted by external consultants. During the year, the Investment Products Department looked at the fees collection procedures of the Licensing and Intermediaries Supervision Departments, and the Finance Department examined the fees collection procedures of Investment Products Department. Both audit reports were submitted to the Audit Committee for comment and approval.

➤ IT Security Review

In addition to the annual internal control review programme, we invited Mr Israel Sendrovic, an ex-Executive Vice President in charge of technology matters for the Federal Reserve Bank of New York, to carry out an IT security review on the Commission in February 2003. Based on his recommendations, the Commission has established an Information Security Unit and an IT Security Committee and started conducting periodic information security risk assessment. The enhanced information security measures have been incorporated in the Commission's

information security policy. Under the policy, all Commission staff are required to attend the information security awareness programme.

Our IT Department is subject to regular review according to ISO 9001:2000 standard for its quality management system.

Independent and External Reviews

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.

We publish our *Quarterly Reports* and *Annual Report* within 45 days after the end of the relevant period and submit them to the Financial Secretary and lay them before LegCo. Moreover, 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. By law, the Director of Audit may examine any books, accounts, vouchers, records or documents kept by the Commission. The SFO also requires the Commission to consult the public in exercising its rule-making powers.

➤ An Independent Review Panel

The Commission's internal procedures for regulating the markets, including procedures for ensuring consistency and fairness, are reviewed on an ongoing basis by the Process Review Panel (PRP), which is an independent, non-statutory panel established by the HKSAR Chief Executive in November 2000. The PRP is tasked to review and advise the SFC upon the adequacy of the SFC's internal procedures and operational guidelines governing the action taken and operational decisions made by the SFC and its staff in the performance of its regulatory functions, including the receipt and handling of complaints, licensing and inspection of intermediaries, and disciplinary action.

The PRP currently comprises 11 members, including eight 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 a NED of the Commission.

Over the last year, the PRP reviewed the Commission's procedures by examining various completed cases. The cases reviewed included the following: registration of intermediaries, registration of Registered Institutions, inspection of intermediaries, prudential visit of intermediaries, authorisation of collective investment schemes, handling of complaints against intermediaries, investigation and disciplinary action, processing of Dual Filing cases, approval of Approved Lending Agents, and handling of takeover and merger transactions.

The PRP met on four occasions in the calendar year of 2003, in addition to six meetings held by the Panel's two working groups - the Working Group on Corporate Finance and Enforcement and the Working Group on Licensing, Intermediaries Supervision and Investment Products. 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 valuable recommendations that cover a wide range of areas relating to specific cases and procedural issues. The Commission has accepted most of these recommendations and explained why a small number of the recommendations may have difficulty in implementation. The PRP published its annual report in May in the past two years.

The reports on PRP's reviews on our internal procedures and the follow-up actions on the Panel's recommendations are submitted to the Audit Committee for consideration.

➤ **Securities and Futures Appeals Panel/Tribunal**

The independent Securities and Futures Appeals Panel (SFAP), 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. The new Securities and Futures Appeals Tribunal (SFAT) consists of a chairman, who is a High Court judge, and two lay members (drawn from a panel of 22 members appointed by the HKSAR Chief Executive).

Five appeals were handled by the SFAP in 2003-2004. Of these five cases, four were in relation to disciplinary decisions made by our Enforcement Division and one licensing decision made by our Licensing Department. Three cases were concluded and decided by the SFAP: one was discontinued owing to the lack of jurisdiction; one with our decision varied; and one with our decision confirmed. Two appeal cases are still in progress before the SFAP.

Seven appeals were lodged with the new SFAT in 2003-2004. Two cases involved substantive applications for review of SFC's decisions, and the SFAT dismissed both. The other one involved application for leave to appeal out of time which was dismissed. Four pending cases are currently in progress before the SFAT. Of these seven cases, all except one are in relation to disciplinary decisions.

A wider range of SFC's decisions will now be subject to review by the SFAT.

➤ **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. The last round of ICAC review was completed in 2001-2002.

Recently, the Government has recommended the Commission to 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 will start in the second half of 2004.

➤ **Public Redress Mechanism**

Members of the public can lodge complaints against the Commission and its staff if they believe that the Commission or its staff have been guilty of maladministration in the performance of their functions.

In 2003-2004, the Ombudsman received three complaints against the Commission. The Ombudsman concluded five cases during the year including two from the year before and found all five complaints not substantiated.

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 was no judicial review 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 2003-2004
Investor Enquiries <ul style="list-style-type: none"> ■ Preliminary response to telephone enquiries ■ Preliminary response to written enquiries 	4 business days 2 weeks	100% 99.98% ¹
General Enquiries <ul style="list-style-type: none"> ■ Preliminary response to enquiries via enquiry@hksfc.org.hk 	4 business days	99.8% ¹
Public Complaints <ul style="list-style-type: none"> ■ Preliminary response to verbal & written complaints 	2 weeks	99.6% ²
Licensing Applications Processing of licensing applications <ul style="list-style-type: none"> ■ Representatives (provisional licence) ■ Representatives (normal licence) ■ Representatives (responsible officer) ■ Corporations ■ Change of accreditation 	7 business days 8 weeks 10 weeks 15 weeks 7 business days	84% ³ 72% ³ 89% ³ 95% ³ 87% ³
Modification/Waiver and Subordinated Loan Applications <ul style="list-style-type: none"> ■ Acknowledgement of receipt upon receiving any application 	2 business days	100%
Investment Products Authorisation <ul style="list-style-type: none"> ■ Take-up of applications upon receipt ■ Preliminary response to applicants after take-up for unit trusts, mutual funds, investment-linked assurance schemes and MPF pooled investment funds ■ Preliminary response to applicants after take-up for other schemes 	2 business days 1 week 2 weeks	100% 100% 100%

¹ Some cases failed to meet the pledge due to the exceptionally heavy workload of the responsible departments when the enquiries were received.

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