

**Speech at the Luncheon of the Hong Kong Institute of Directors
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**“The Role of the SFC Chairman –
Towards a More Effective and Efficient Securities Market”
26 January 2007**

Chairman Mr Peter Wong,
Fellow members,
Distinguished guests

Introduction

It is my honour to be invited to the Institute luncheon today. As a member of the Institute, it makes me feel very much at home speaking to my fellow members and such an assembly of distinguished guests.

Agreeing to speak is easy, but choosing an appropriate topic for the occasion requires careful thoughts. I have been told that I can choose my own topic, provided that it is one of “significance to company directors and the Hong Kong financial market”.

Having given it some thought, as I am fairly new to the job, I believe many of you are here because you want to find out about the role of the new SFC Chairman and my views on the direction of the Commission. My talk today therefore will be in two parts.

First, I would like to talk about my role as a “Non-Executive Chairman”, a title which is distinctly different from that of my predecessor, who was at the time a full time Executive Chairman. I think there could not be a more appropriate occasion to discuss my role as SFC Chairman than a luncheon of the Institute.

Second, I would like to share with you how I intend to lead the SFC in the next three years, and how the SFC may contribute to facilitating Hong Kong’s development as an international financial centre (IFC).

The “Non-Executive Chairman”

This position was created through the introduction of the Securities and Futures (Amendment) Ordinance 2006 in June last year. With the rapid development of the securities and futures markets, the Government saw the need to continually enhance the internal governance and regulatory structure to ensure the effective functioning of the

SFC in order to meet the future challenges. This is because, as noted by the Government¹, the SFC has an important role to play in maintaining Hong Kong's position as an IFC. The Amendment Ordinance provides for the separation of the role of the Chairman from that of the executive arm, which is now headed by a Chief Executive Officer (CEO).

The Chairman leads the Board in setting the overall directions, policies and strategies of the Commission and in monitoring the performance of the executive arm. The CEO has the executive responsibility for the day-to-day running of the Commission. He is there to implement the objectives set by the Board, and facilitate the effective functioning of the Commission. This role model is very similar to the best governance practices both in commercial organisations and public bodies, e.g. MPFA (Mandatory Provident Fund Schemes Authority), Hong Kong Mortgage Corporation Ltd, and MTR Corporation Ltd.

If you have the opportunity to visit the SFC website (www.sfc.hk), you will find that the respective roles and responsibilities of the Chairman and CEO have been clearly set out. They have been thoroughly debated in the legislature and endorsed by the Commission Board during the passage of the Bill. Without going into details, there are 11 separate items of responsibilities for the Chairman and 14 for the CEO. It is only logical that the CEO gets a longer list, as he is a full time executive.

The position of a Non-Executive Chairman is a public service appointment, and as Chairman, I receive a moderate sum of honorarium. Some commentators, you may recall, suggested that the Government should pay more in order to attract the right candidate. However, when I was first approached to take on this appointment, remuneration was not my prime consideration. My concerns were focused on the heavy responsibilities of the post, the high expectations of the public and the amount of time and efforts that are required for the position. I also recognised the need to make certain sacrifice because I need to perform my duties impartially and be seen to do so. For example, I have to resign from all my previous involvement with publicly listed companies such as acting as Independent Non-Executive Directors. In addition, under the Securities and Futures Ordinance (SFO), I need to comply with strict requirements on the preservation of secrecy (section 378) and avoidance of conflicts of interests (section 379). I am also subject to the SFC's internal Code of Conduct.

Although the position is non-executive, I am also expected to devote as much time as is required and make the SFC the priority of all my commitments. You can well imagine that.

So, it was only after some very hard thinking that I finally agreed to take up the appointment. And I was deeply honoured to be appointed.

So much for the time being on my role as Chairman. I would like to share with you some of the challenges facing the Commission as I see them, and the way forward.

¹ The Secretary for Financial Services and the Treasury, Mr Frederick Ma, when moving the resumption of the Second Reading of the Securities and Futures (Amendment) Bill 2006 on June 14, 2006.

My priorities

Many of you may remember that, when I took up this appointment three months ago, I set out four of my priorities:

1. to provide leadership to the SFC Board to ensure that all members participate and contribute fully in setting strategies and directions of the Commission;
2. to ensure that the CEO and I discharge our duties in a complementary manner;
3. while carrying out its regulatory duties, the Commission should be mindful that it has another important role to play, which is to facilitate Hong Kong's ongoing development as a leading international financial centre; and
4. to maintain close and regular ties with our counterparts in the Mainland.

I am pleased to report that progress has been made in each of these areas. I will give you some highlights.

Board involvement

At present, the Board is made up of a Non-Executive Chairman, six Executive Directors and seven Non-Executive Directors. The Board meets once a month and its committees – on audit, remuneration and budget – meet regularly to discharge their functions. As I previously mentioned, the role of the Executive Chairman has been changed to a non-executive one which means that the Chairman, in his new capacity, would have more time to devote to leading the Board and to communicate more frequently with the stakeholders.

I believe that the most vital role of the Chairman is to call upon all members of the Board to fully participate in the affairs of the Commission, which include not only spending time considering and endorsing proposals put forward by the executives, but also setting strategies and directions for the future. Together as a Board we should bring “an independent and informed judgment” to bear on every matter that comes to the Board for decision. I am currently working with my executive team to put forward an annual business plan to the Board to ensure that the objectives for the coming year are fully captured and will be implemented in a timely manner.

Roles of Chairman and CEO

Another of my priorities concerns the roles of the Chairman and the CEO. I have at the outset mentioned the background, so I won't repeat that here. I have scheduled regular meetings with the CEO, Mr Martin Wheatley, and I am in close contact with him and indeed other EDs on a regular basis.

However, effective governance, whether in a commercial or public body, in my view requires a close working relationship between the Chairman and the CEO which is characterised by trust, openness and communication. Here are a few examples of what needs to be done:

- First, have regular dialogues with the CEO. Stay on top but stay out of details. Always have sufficient knowledge on major issues and be prepared to respond to queries from other Board members and external parties.
- Second, be honest and constructive with the CEO on issues to be addressed. When an issue comes up, discuss openly how it should be dealt with.
- Third, be a sounding board for the CEO. Advise him the likely Board opinions on certain issues and the time they should come to the Board.
- Fourth, defend the CEO from unfair or unreasonable criticisms as and when necessary.
- Finally, engage in an ongoing process of performance feedback for the CEO and his executive team. Engage on a “no surprise” approach and don’t delay until the “annual review”.

Overall, I think it is most important to build mutual trust between the Chairman and the CEO.

A more effective and efficient Commission

I would now turn to the third point, i.e. how the SFC may enhance its effectiveness and efficiency to facilitate Hong Kong’s development as an IFC.

When I took office in October last year, I recognised that the SFC, like any public body, has to not only be accountable to the public, but also measure itself up to the stakeholders’ expectations.

But what are the expectations of the SFC stakeholders? We have just released a Stakeholder Survey report, and I would like to share with you some of the findings:

- The survey, conducted by an independent market research firm, interviewed stakeholders including market practitioners and other professionals - and company directors too. The survey found that the SFC was generally highly regarded and viewed to have conducted its regulatory activities impartially and to have effectively enforced the Hong Kong market.
- Stakeholders regarded the SFC as approachable and overall, the best securities regulator in Asia.
- On the other hand, stakeholders also expressed their expectations about the SFC, including that the SFC should support Hong Kong’s competitiveness in a global market.
- For instance, stakeholders would like the SFC to be more proactive in developing Hong Kong as a major financial centre and be less conservative in its approach to the introduction of new products. They also wanted us to improve the speed of response in certain areas, although you may be aware that we already have performance pledges covering some areas of our work.

The message is very clear: our stakeholders have high expectations. Their comments should not be taken lightly. The Commission, within the regulatory objectives set down in law², should strive to explore how it may contribute to making Hong Kong a competitive IFC. We have to ask ourselves some critical questions such as the following:-

- Can the SFC move in tandem with the changes in the globalised marketplace and respond promptly to the needs of the market with a pro-business approach, so as to ensure Hong Kong's continued success?
- Can we conduct our regulatory activities more effectively and efficiently by streamlining our processes?
- Can we maintain an active, open dialogue with the industry at the senior level, and at the same time ensure that our frontline staff are capable and adequately resourced to handle matters raised by market participants?

I am an optimist, so I think the answers to all these questions must be “yes”. It is a matter of “how” we may achieve that, “how” we can better ourselves and “how” we benchmark ourselves against similar institutions in terms of performances and pledges. These are what the Commission should carefully consider as a matter of utmost importance.

On the Mainland

It goes without saying that the Hong Kong market's continued growth and prosperity depends to a large extent on the development of the Mainland market. The influence of Mainland enterprises on our market has been increasing rapidly. At the end of 2006, 47% of the market capitalisation in HKEx was accounted for by PRC enterprises³. The comparative percentage was 37% a year ago. PRC enterprises accounted for 43% of the total turnover in 2006.

And hence our need to continue strengthening our relationship with our counterparts in the Mainland such as the China Securities Regulatory Commission (CSRC), the People's Bank of China and the State Administration of Foreign Exchange. My colleagues and I visit the Mainland regularly and meet senior officials of the various authorities. In addition, we work closely with the CSRC on international regulatory issues at meetings of the IOSCO, or the International Organization of Securities Commissions – of which both the CSRC and SFC are members.

Maintaining regular dialogue and exchanges of personnel are essential to fostering the link between the two places which in the long run will help to yield win-win results.

Some of you may have read the Report on Economic Summit in response to China's 11th Five-Year Plan last week. There are some 80 initiatives for the financial sector, many of which the SFC is closely associated with. The SFC should study what role we can play and respond positively to the Action Agenda.

² Section 4 of the SFO.

³ These include H shares and red chips.

What is the way forward for the SFC?

- The SFC has a core mission to protect the interest of investors. We must therefore set high regulatory standards for the market and encourage the use of best practices. We must continue to enforce against misconduct and illegal practices in the market firmly and fairly. This cannot be compromised.
- But our rules and regulations must be *effective* without creating unnecessary or undue compliance burdens, and our processes must be *efficient* and user friendly.
- The SFC has a key role to play in supporting Hong Kong's continued development as a leading IFC. We will join hands with our stakeholders, such as HKEx, and the Hong Kong SAR Government to leverage on the existing strengths of Hong Kong as a financial centre.
- Last but not least, the SFC will continue to educate investors – but everyone, including each and every member of the Institute, has a role to play in this.

Conclusion

Fellow members and guests, overall I have only one simple message to deliver. I consider that it is essential for the SFC as a regulator to find the right balance between investor protection and facilitation of market development. I regard this a major challenge, and possibly the biggest challenge, for the Commission. However, I cannot do this by myself. I shall work closely with my SFC colleagues and, of course, our stakeholders in the financial community like you.

Thank you.