
CHAPTER 4

ORGANIZATION, COMMUNICATION AND CONSULTATION CHANNELS

INTRODUCTION

4.1 The success of the three-tiered structure hinges on a clear division of responsibilities amongst the parties, a clear understanding of where the divisions lie, and co-ordination within and amongst the respective organizations. This chapter identifies the parties involved in the regulation of the securities industries, outlines the communication channels within and amongst them, and elaborates on the mechanisms through which they gauge and assess market views.

RELEVANT PARTIES

The First Tier – The Government

4.2 Within the Government, the Financial Secretary (FS) is the most senior official having broad policy direction and governance over the financial, economic and employment sectors. The Secretary for Financial Services and the Treasury (the Secretary), as one of the eleven Directors of Bureau, is the head of the Financial Services and the Treasury Bureau (the Bureau) and, in a sense, the custodian of policies in financial services and public finance. He is responsible for determining policy objectives and goals. This would include the initiation, formulation and implementation of policies and to monitor their effectiveness in areas of financial services. The division of responsibilities between the FS and the Secretary is considered and discussed in greater detail in Chapters 6 and 12. We shall refer to the parties as the FS, the Secretary and the Bureau. The Secretary is also referred to in places as the SFST.

4.3 Within the Bureau, the Secretary is underpinned and assisted by the Permanent Secretary for Financial Services and the Treasury (Financial Services) whose portfolio covers the whole financial services sector. We refer to him as “the Permanent Secretary”. There is a team of three civil servants directly involved in the interface with the securities sector. The organizational chart is detailed at **Annex 4.1**. For the purposes of our

report, the FS is the Honourable Antony Leung, the Secretary is the Honourable Frederick Ma and the Permanent Secretary is Mr Tony Miller.

The Second Tier – The SFC

4.4 The SFC is a statutory body appointed by the CE. There are currently 11 Directors, five of whom are Executive Directors, including a Chairman, and six are independent Non-Executive Directors²⁴. The Commission is supported by six committees, details of which are at **Annex 4.2**. The SFC has a total staff of just over 400 in four operational divisions and two supporting divisions²⁵. The Corporate Finance Division, under the direction of an Executive Director, is responsible for, among other things, overseeing the Stock Exchange's listing-related functions and responsibilities. The Division has a staff of 36 (26 executives and 10 supporting staff). Details of the organization of the Corporate Finance Division is at **Annex 4.3**. Within the SFC, the Corporate Finance Division (and the SFC Chairman who oversees all divisions) is involved in the regulation of listing matters. At all material times, the Chairman of the SFC is Mr Andrew Sheng and the Executive Director of the Corporate Finance Division is Mr Ashley Alder.

The Third Tier – The HKEx

4.5 The HKEx is a listed company governed by a Board of Directors consisting of 15 members (1 executive and 14 non-executive directors including a Chairman). In addition, there are six Committees²⁶ and three Panels²⁷ with members drawn from a wide spectrum of the business and professional sectors. **Annex 4.4** sets out the relationship and membership of the Board and its Committees. The Terms of Reference and membership of the Consultative Panels are at **Annex 4.5**.

²⁴ When the new Securities and Futures Ordinance comes into force, there would be no fewer than eight members of the Commission, and the majority must be Non-Executive Directors.

²⁵ The four operational divisions are Corporate Finance Division, Intermediaries & Investment Products Division, Supervision of Markets Division and Enforcement Division. The two supporting divisions are Legal Services Division and Corporate Affairs Division.

²⁶ The six Committees are (a) Executive Committee; (b) Audit Committee; (c) Investment Advisory Committee; (d) Risk Management Committee; (e) Remuneration Committee; and (f) Nomination Committee.

²⁷ The three Panels are: (a) Cash Market Consultative Panel; (b) Clearing Consultative Panel; and (c) Derivatives Market Consultative Panel.

4.6 The Chief Executive of the HKEx oversees seven functional units including the Listing, Regulation & Risk Management Unit²⁸, and supervises four business units through a Chief Operating Officer²⁹. An organizational chart of the HKEx is at **Annex 4.6**. The Chief Executive of the HKEx, at all times material to this report, is Mr K C Kwong.

4.7 Within the HKEx, the Listing, Regulation & Risk Management Unit is directly responsible for performing the regulatory function of the HKEx. The Head of this Unit is Ms Karen Lee. Its Listing Division supervises the listing process and the ongoing compliance by issuers with their obligations under the listing rules. Its organizational chart is at **Annex 4.7**. In addition, the HKEx's Corporate Communications Unit operates as a "two-way conduit" between the HKEx and the public. It handles media relations as well as investor relations and education programmes.

4.8 The person and bodies involved in listing matters are the Chief Executive of the HKEx, the Listing Division and the Listing Committee. The Corporate Communications Unit would only be indirectly involved.

Segregation of the HKEx's Business and Regulatory Functions

4.9 As provided for in the Amended and Restated Memorandum of Understanding Governing Listing Matters (MOU) signed by the SFC and the Stock Exchange of Hong Kong (SEHK)³⁰ on the 6th March 2000, the SEHK is "solely responsible for the day-to-day administration of all listing related matters with respect to the stock market in Hong Kong"³¹. As the HKEx has both business and regulatory functions, the HKEx's administrative structure is designed in such a way that a "Chinese wall" exists within the organization, segregating the business units from the regulatory unit. This mechanism seeks to ensure that the HKEx is, and is seen to be, performing

²⁸ The other six functional units are (a) Corporate Communications; (b) Corporate Strategy; (c) Finance, Treasury & Administration; (d) Group Internal Audit; (e) Human Resources; and (f) Legal & Secretarial Services.

²⁹ The four business units are Exchange, Clearing, E-Business & Information Services as well as IT/Systems.

³⁰ The Stock Exchange of Hong Kong Limited (SEHK) is one of the subsidiaries of the HKEx, the holding company. Other subsidiaries include the Hong Kong Futures Exchange Limited and the Hong Kong Securities Clearing Company Limited.

³¹ Paragraph 2.4 of MOU.

its regulatory function in a fair and independent manner, not influenced by its own business considerations. In line with this approach, the HKEx Board has delegated its functions and powers in relation to listing matters to the Listing Committee. The Board does not exercise concurrent jurisdiction in relation to any matters to do with listing. The Board is neither involved in nor informed of policy and operational matters relating to listing. This is a matter of importance and the roles of the Board and the Listing Committee are often misunderstood even by those in the industry.

The Listing Committee

4.10 With the delegated authority from the Board, the Listing Committee is the “gatekeeper” for all listing issuers, though aggrieved parties may appeal to the Listing Appeals Committee of the HKEx chaired by the Chairman of the HKEx. There are currently two Listing Committees, one for the Main Board and the other for the Growth Enterprise Market. The Listing Committee has a membership that is “broadly representative of the various securities industry groups with interests in the proper regulation of the stock market”³². All Listing Committee members are nominated by an independent Nomination Committee³³ and approved by the Board of the SEHK³⁴. Currently, there are 25 members serving on the Main Board Listing Committee, including six Exchange Participants³⁵ or their directors, six representatives from listed companies, twelve market practitioners and users and also the Chief Executive of the HKEx. At present, the Chairman of the Listing Committee is not a director of the HKEx Board. The Chief Executive is the only bridge between the HKEx Board and the Listing Committee. The current membership and terms of reference of the Listing Committee for the Main Board are at **Annex 4.9**³⁶.

³² Paragraph 2.6 of MOU.

³³ The Nomination Committee has three SFC representatives and three HKEx representatives.

³⁴ See Annex 4.8.

³⁵ Under the Listing Rules, "Exchange Participant" means a person: (a) who, in accordance with the Listing Rules, may trade on or through the Exchange and (b) whose name is entered in a list, register or roll kept by the Exchange as a person who may trade on or through the Exchange.

³⁶ The appointment and functions of the Listing Committees are set out in the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited approved by the HKEx Board and by the SFC, and made under section 34 of the Stock Exchanges Unification Ordinance. The appointment of the Listing Committee is stipulated in Listing Rule 2A.20 to 2A.23.

4.11 The main reason given for placing listing matters under the HKEx is that the HKEx is closer to the market. The staff of the HKEx is expected to have the necessary market expertise and experience. The HKEx would also have access to a large pool of market practitioners through its extensive network.

CO-ORDINATION WITHIN AND AMONGST DIFFERENT PARTIES

Within the First Tier – The Government

4.12 Before 1 July 2002, the Secretary for Financial Services and the securities team in the Bureau were geographically located in the same office, in Admiralty Centre. They had frequent contacts through meetings, oral and written exchanges. They saw each other in and around the office. Starting from 1 July 2002, the Secretary for Financial Services and the Treasury (the Secretary) has his personal private office headed by an Administrative Assistant. This is now situated at the Central Government Offices. The Permanent Secretary and the other Bureau staff responsible for securities matter remain in Admiralty. Correspondence between the Bureau goes through the Administrative Assistant to the Secretary, who screens the incoming mail for the Secretary. The different geographical location of the two offices assumed significance in the course of the events in July 2002. It may have contributed to a degree of miscommunication and misunderstanding which led to unfortunate consequences.

Within the Second Tier - The SFC

4.13 The Chairman of the SFC has regular meetings with his Executive Directors. He also chairs and participates in Commission meetings and some Committee meetings. The day-to-day operation of the Divisions rests with the Executive Directors, who keep the Chairman informed of major issues.

Within the Third Tier – The HKEx

4.14 The Chief Executive of the HKEx has regular meetings with his senior staff. The Listing, Regulation & Risk Management Unit reports directly to the Chief Executive, who attends monthly meetings with the senior executives of the Unit and receives their reports on the general

progress of major tasks. In addition, the Unit Head reports, discusses and seeks approval and guidance from the Chief Executive on all key issues.

Between the First and Other Tiers

4.15 Between the first tier and the other two tiers, there are four major forums to co-ordinate and discuss matters of common concern:-

- (a) ***The FS' regular meeting with the SFC and the Secretary*** is held about nine times a year to discuss major developments in the financial market and to keep the FS posted on the general direction of major market reform initiatives.
- (b) ***The Securities and Futures Liaison Meeting*** is a general liaison meeting between the Bureau and the SFC on, essentially, housekeeping matters. It is chaired by the Secretary and held on a monthly basis. Details are at **Annex 4.10**.
- (c) ***The Tripartite meeting*** is another liaison group comprising the Bureau, the SFC and the HKEx to facilitate the general monitoring of issues affecting the development of the securities and futures market in Hong Kong and, from the Bureau's perspective, to increase the communication channels between the SFC and the HKEx. Meetings are held every other month. Details are at **Annex 4.11**.
- (d) ***The Co-ordination Committee*** was set up in 2001 to identify, discuss and resolve regulatory and policy issues and to facilitate the HKEx's implementation of its new strategic plan³⁷. Details are at **Annex 4.12**. This is a small group chaired by the HKEx Chairman and consists of the Permanent Secretary, the Chief Executive of the HKEx and the SFC Chairman, assisted by a senior Deputy Secretary of the Bureau. Meetings are held once every two to three months.

4.16 In addition, the Secretary also chairs the Financial Market Development Task Force and the Financial Stability Committee, both of which discuss issues concerning the financial market in general rather than

³⁷ The New Strategic Plan is also referred to as "the McKinsey Report".

the securities market in particular. The SFC Chairman is a member of both committees³⁸.

Between the Second and Third Tiers

4.17 Apart from the two forums mentioned in paragraph 4.15(c) and (d), the senior management of the SFC and the HKEx do not have regular meetings to discuss matters of common concern. At the operational level, staff of the SFC and the HKEx have frequent contact over the telephone, e-mail and written exchanges. For listing matters, the Corporate Finance Division of the SFC and the Listing, Regulation & Risk Management Unit of the HKEx conduct monthly liaison meetings. The terms of reference and membership of these meetings are at **Annex 4.13**.

CONSULTATION AND MARKET ASSESSMENT

4.18 The Government, the SFC and the HKEx each have fairly extensive networks to gauge public opinion.

The Government

4.19 As part of the Government's ongoing efforts to engage market participants, the Bureau has had meetings with the stockbroking community since 1995. In the context of steering the Securities and Futures Bill through the Legislative Council, the Bureau intensified these efforts and monthly luncheons with the Hong Kong Stockbrokers Association have turned into regular meetings since mid 2000.

The SFC

4.20 The SFC also has an extensive consultation network:-

³⁸ The Financial Market Development Task Force is chaired by the Secretary to identify and co-ordinate, where necessary, new initiatives in promoting the development of Hong Kong's financial markets, with a view to maintaining the status of Hong Kong as an international financial centre. Other members include the Chief Executive of Hong Kong Monetary Authority, Commissioner of Insurance, Director-General of Investment Promotion, InvestHK and Managing Director of Mandatory Provident Fund Schemes Authority. The Financial Stability Committee monitors the functioning of the financial markets in Hong Kong, including the money, foreign exchange and securities market, and deliberates on events, issues and developments with possible cross-market and systemic implications, and where appropriate, formulates and co-ordinates response.

-
- (a) ***The SFC Advisory Committee*** was established under the SFC Ordinance (Cap. 24). It has a broad-based membership representing the interests of investors, intermediaries, listed companies and other participants. Its membership and terms of reference are at **Annex 4.14**. Under the recently re-enacted Securities and Futures Ordinance, the Advisory Committee must meet at least once every three months and additional meetings may be convened by the SFC Chairman or any three other members. It serves as a bridge for the SFC to reach providers and users of financial services in the securities and futures market.
- (b) ***The Shareholders Group*** was formed in early 2001 as a forum to gauge the views of shareholders and consumers. The underlying belief is that maintaining a level playing field among all shareholders and holding directors and management of listed companies accountable to shareholders are pivotal to enhancing investor confidence, safeguarding market integrity and ensuring the proper functioning of the securities market. Through bi-monthly meetings, the Shareholders Group serves as the SFC's advisor on different aspects of the regulatory framework relating to the protection of minority shareholders and enhancing good corporate governance. Its membership and terms of reference are at **Annex 4.15**. It has, since June 2002, been upgraded to a statutory committee under section 6 of the SFC Ordinance (Cap. 24).
- (c) ***Specialized Standing Committees*** are formed under section 6 of the SFC Ordinance to assist its work. There are currently more than ten such committees involving the market and the investing public. Examples are the Committee on Unit Trusts, the Takeovers and Mergers Panel and the Investor Education Advisory Committee.
- (d) ***Working Groups*** of relevant expertise are set up to assist the SFC formulate draft rules, codes and guidelines on specific subjects, such as the regulation of Automated Trading Services. The practice is to release preliminary drafts to the relevant working groups for consideration and technical input. Amendments are then made in the light of their contributions

before released for public consultation. Most of these rules deal with technical issues. The SFC takes into account expert views on the drafts in their formative stages. It also seeks input from the Consumer Council, institutional investors, academics and others on relevant subjects.

4.21 The SFC usually adopts a two-stage process for outside consultation when formulating new proposals to amend subsidiary legislation or any of its codes. Before embarking on public consultation, the SFC conducts informal soundings through its consultation networks. The aim is to test the key concepts with knowledgeable individuals of repute, especially those who can be counted on to maintain confidentiality. The SFC also engages practitioners in the drafting process, where appropriate, through working groups and standing committees.

The HKEx

4.22 As mentioned in paragraph 4.5, the HKEx has a large family of non-executives serving on its various boards and panels. This is a large pool of market experience and expertise.

- (a) All **Directors of the Board** are distinguished members of the community drawn from business and the professions. Either individually or collectively, Directors provide a ready repertoire of advice and skills on matters relating to the HKEx.
- (b) The three **Panels** were set up to advise on specific business areas namely, the cash market, derivatives and clearing. As illustrated in **Annex 4.5**, the Panels provide market expertise and advice to the Board on international trends, the needs of intermediaries, issuers, investors and other market participants, technological challenges and new product opportunities in the respective markets. The Panels also serve generally as a “sounding board” for policy recommendations, strategic initiatives and major investments in respective of the various markets.
- (c) The **Listing Committee**, with its wide representation based on market knowledge and experience, provides specific advice on listing and other incidental regulatory matters.

-
- (d) On non-listing matters, the HKEx has also, on occasions, set up ad hoc **working groups** to study issues of concern to the market.