

BY FAX AND BY POST
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29 November 2002

Secretary,
Expert Group to Review the Operation
of the Securities and Futures Market
Regulatory Structure,
Room 716, Central Government Offices,
Main Wing, Lower Albert Road,
Central, Hong Kong.

Dear Sir,

Thank you for your letter to the President of the Hong Kong Society of Accountants, inviting the Society's views on the issues to be considered by the Expert Group to Review the Operation of the Securities and Futures Market Regulatory Structure.

The Society is supportive of the review and believes that significant structural changes have taken place in recent years that have implications for the operation and regulation of the securities and futures markets. We would suggest that the impact of these changes needs to be considered carefully in determining the most appropriate legal and regulatory framework for oversight of Hong Kong's markets in the future. These changes include the demutualisation and listing of the Stock Exchange, the setting up of a "ministerial system" of principal officials in the Hong Kong SAR Government, the consolidation of the securities law, as well as general developments within the field of corporate governance.

We anticipate that specific proposals arising from the review will be subject to further consultation and so at this stage we have confined our comments to broader matters of principle. We indicate below some issues and questions that in the Society's opinion, should be considered in the course of conducting the review.

Role of the Government

With the recent introduction in Hong Kong of a "ministerial system" and the appointment of new principal officials, the respective roles of the Chief Executive of the Hong Kong SAR Government ("CE"), the Financial Secretary ("FS"), the Secretary for Financial Services and the Treasury and the Financial Services Branch ("FSB"), in relation to the oversight and operation of the securities and futures markets, need to be further clarified, given that uncertainty invariably has a negative effect on the smooth operation of markets. The following questions should also be considered:

1. Reserve Power

Is it still appropriate for the CE to have the power to give the Securities and Futures Commission ("SFC") written directions as to the furtherance of any of its regulatory objectives or the performance of any of its functions, in the public interest (section 11 of the Securities and Futures Ordinance ("SFO"))?

2. Under the SFO, the Government (i.e. the CE) appoints and can remove directors of the SFC, as well as determining their remuneration, etc. In addition, the Government (i.e. the FS) can appoint a majority of directors of Hong Kong Exchanges and Clearing Limited (“HKEx”). Is this degree of governmental control appropriate in an international market place and are there circumstances in which this might give rise to uncertainty in the operation of the markets?
3. Role of FSB as Facilitator and Coordinator

The FSB acts as a facilitator and a coordinator, as opposed to a regulator, without statutory powers of enforcement? How effective is this role and if it is not assuming a regulatory role, is FSB’s current role really necessary?

All in all there needs to be a clearer definition of the role of the Government in the process of regulation of the securities and futures markets.

Role of the Securities of Futures Commission

The scope of the role of the SFC has developed since it was first established. With the implementation of the SFO, the operation and regulation of the securities and futures markets are now governed by one of the most extensive pieces of legislation on the statute book in Hong Kong. However, has this served to delineate the roles and functions of the different parties in the market more clearly or has it in practice entrenched areas of uncertainty and overlapping responsibilities? Other issues are:

4. Single Regulator of the Securities and Futures Markets
Should there be a single securities and futures regulator in Hong Kong, as in the UK? Should it be a statutory body?
5. Single Regulator of Listed Companies and Intermediaries
Following on from question 4, above, should the regulation of listed companies and securities and futures intermediaries be carried out by a single authority?
6. Independence and Funding of SFC
Should the SFC be an independent non-governmental body funded independently of the Government?
7. “Dual Filing” - Duplication of Roles
Is the system of dual filing, under the proposed Securities and Futures (Stock Market Listing) Rules, a duplication of roles and so of resources and costs?
8. Role of SFC Chairman and Directors
Should the chairman of the SFC be regarded as an executive director by virtue of his office, as currently specified under the SFO (Schedule 2, Part 1, paragraph 2)? Should the chairman or directors of the SFC be eligible to be appointed by the Government to sit on the board or committees of HKEx?

9. Functions of the SFC and the Hong Kong Monetary Authority

Are the respective roles and responsibilities of the SFC and the Hong Kong Monetary Authority in relation to the securities operations of banks sufficiently clear and distinct as regards both the framework and its implementation? Should all securities business be regulated by a single regulator?

Role of Hong Kong Exchanges and Clearing Limited

The status of HKEx has changed since it was successfully listed on the Hong Kong Stock Exchange. Does this change in status have implications for HKEx's regulatory functions? More specifically:

10. HKEx's Listed Company Status

Much of HKEx's income derives from the turnover of transactions in relation to a limited number of listed companies? Does this create potential conflicts between its interests as a profit-making entity and, for example, the interests of retail and other investors in smaller, less actively-traded, listed companies?

11. The regulatory functions of HKEx are a cost centre. Bearing in mind the main source of its revenues, can it continue to be an effective regulator while at the same time being a listed company, whose main objectives must include maximising returns for its shareholders?

12. Non-statutory Status of HKEx and the Listing Rules

Is it appropriate for the listing rules to be administered by a non-statutory regulator like the HKEx?

Should the enforcement of listing rules continue to be in effect a contractual matter between HKEx and listed companies, or should the listing rules be given statutory backing? Under a non-statutory system, breaches of rules may in practice result only in private/public reprimands. Under a statutory system, like the UK Financial Services and Markets Act 2000, breaches of rules can give rise to more stringent penalties, such as fines and other sanctions.

Does the current regime provide a sufficient deterrent against misconduct by market players and participants? If not, what mechanisms should be put in place to ensure effective enforcement to achieve the objective of the listing rules?

Regulatory Gap

Currently there is a gap in the regulatory regime for companies in Hong Kong – be they private, public or listed.

13. The Hong Kong Companies Registry is primarily a registration body which does not have the resources to conduct investigations into companies and enforce fully the provisions of the companies law. In addition, the

enforcement function is a cost centre and as a trading fund the Registry is expected to operate along commercial lines.

14. The responsibilities of the Official Receiver's Office (ORO) in this regard relate mainly to companies being wound up by the court. Whilst the ORO also has powers to seek the disqualification of directors, this again is essentially in relation to matters uncovered in the administration of insolvencies.
15. The focus of HKEx's enforcement role relates to the compliance by listed companies with the non-statutory listing rules. It should also be borne in mind that a substantial proportion of listed companies are incorporated offshore and are not subject to the statutory regulatory regime of the Companies Ordinance.
16. Under the SFO, the SFC has limited powers in relation to specific offences and other matters that may affect listed and related companies.
17. The FS has powers to appoint inspectors under the SFO and the Companies Ordinance.
18. There is thus no comprehensive regime of regulatory oversight of companies in Hong Kong. We believe that this is an important aspect of the review which should not be overlooked.

Other Matters

19. Regulatory Arbitrage

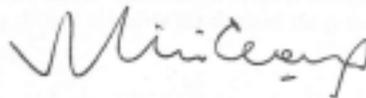
Is there scope for regulatory arbitrage under the existing three-tier system and does this point to the need for structural changes to be made to the system?

20. A Third Board or an Over-the-counter Market

Should there be a third board or an over-the-counter market for penny stocks?

We trust that you will find our comments to be helpful and look forward to being invited to comment further on any specific proposals that arise from this review in due course.

Yours faithfully,



WINNIE C.W. CHEUNG
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PROFESSIONAL & TECHNICAL DEVELOPMENT
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