

SFS' speaking notes on corporate governance

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The following is a synopsis of the points made by the Secretary for Financial Services, Mr Stephen Ip, at the Legislative Council Panel on Financial Affairs meeting today (March 14):

Good corporate governance is the key to improving economic efficiency, enhancing the attraction of our market and investors' confidence, as well as maintaining the stability of our financial system. Enhancing Hong Kong's corporate governance regime is a priority of our work. We have all along attached much importance to, and dedicated considerable efforts in, reforming our legislation and rules to keep them up to date.

Good progress has been made by the Administration, the Standing Committee on Company Law Reform (SCCLR), the Securities and Futures Commission (SFC), the Hong Kong Exchanges and Clearing Limited (HKEx) and professional bodies concerned in carrying out this priority task in the past two years. Our hard work has been well recognised. The Managing Director of the International Monetary Fund said last year that Hong Kong was the standard setter for corporate governance and transparency in Asia. According to Standard and Poor's Corporate Governance Study on Hong Kong published in January this year, Hong Kong is a leader in the domain of corporate governance in Asia.

#### Protection of Shareholders' Rights

In the context of protection of shareholders' rights, progress has been achieved in the following areas -

\* In its Consultation Document published in July last year, the SCCLR proposed a number of amendments to enhance shareholders' rights. These include amending the law to provide shareholders with a more meaningful procedure by which to nominate

and elect directors; introducing statutory derivative action, whereby the SFC will be empowered to bring derivative actions against wrongdoers in relation to listed companies, subject to the proviso that the SFC shall exercise its power in the public interest as well as in the interest of the company. The public comments received indicated support for the proposals. We are taking forward such proposals and proceeding to amend the law.

\* Measures to protect shareholders are also contained in the Securities and Futures Ordinance enacted by the Legislative Council yesterday. These include providing expressly for a private cause of action for a person to seek compensation for pecuniary losses suffered as a result of relying on any public communication relating to securities or futures contracts, which is false or misleading. Such compensation may be sought from the person responsible for disseminating the information, e.g. directors or senior officers of a company. The intention is to ensure that persons responsible for issuing public communications, such as listed companies, should exercise due care and diligence in doing so, so as to ensure the accuracy of the information released.

\* The new Ordinance also creates an express private right of civil action for a person to sue another person for recovery of pecuniary losses resulting from the latter's market misconduct, such as insider dealing and stock market manipulation. This allows the court hearing on such a private action to admit findings of the Market Misconduct Tribunal and criminal convictions as evidence. This would help investors to establish their claims, without having to prove afresh the existence of market misconduct.

\* Tighter voting mechanism for connected transactions by interested shareholders; stricter rules against the dilution of shareholders' interests through placing of shares, rights issues and share repurchases are proposed by the HKEx in its Consultation Document on changes to the Listing Rules. These proposals are along a similar vein of those made by the SCCLR. I welcome members' comments on such proposals.

Enhance Transparency and Measures to Combat Market Misconduct

In relation to enhancing transparency -

\* The Securities and Futures Ordinance mentioned above has put in place a disclosure regime that is in line with international standards. The initial disclosure threshold for substantial shareholders has now been lowered from 10% to 5%, and the notification period has been shortened from 5 to 3 business days.

\* The provisions in the Securities and Futures Ordinance have also enhanced the investigatory powers of SFC, including the power to seek assistance from a listed company's bank, auditor or business counterpart so as to verify information obtained from an investigation. This facilitates the SFC to investigate into market misconduct behaviour that would undermine the interest of shareholders of listed companies. The imminent establishment of the Market Misconduct Tribunal and the expansion of the route for criminal action under the Ordinance would strengthen the civil and criminal measures available to combat market misconduct behaviour. These measures help to deter manipulation of market and stock prices, as well as the disclosure of false or misleading information for inducing transactions.

\* Timely disclosure of quality information by listed company is important. In this connection, the HKEx's Consultation Paper suggests listed companies to publish quarterly reports within 45 days after the quarter-end. Issuers will be required to publish their half year results announcements within 2 months of the relevant financial period. Again, I welcome members' views on such disclosure proposals.

Promoting Good Directors and Board practices

Establishing good director and board practices would be conducive to ensuring that directors and their boards act responsibly in the governance of their companies and be accountable to shareholders for asset and resources entrusted to them -

\* The Standing Committee's Consultation Paper contains proposals in relation to

directors' duties. Furthermore, the Standing Committee has proceeded with the second phase of its corporate governance review, and is drafting a non-statutory statement on the duties of directors for public reference. The Standing Committee will also examine the development of training programmes for directors.

\* The HKEx will issue further guidance on the independent role of the Independent Non-Executive Directors (INEDs). The Listing Rules consultation document proposes that at least one of the INEDs will be required to have appropriate professional qualifications and issuers will be required to appoint INEDs representing not less than one-third of the members of their boards or not less than 2 in any event. The HKEx also recommends that the roles of Chairman and Chief Executive Officers should be segregated as a good practice. Issuers will have to disclose the nature of audit work they engaged, amount of audit and non-audit fees as well as directors' remuneration. Stricter rules on disclosure of securities transactions by directors are also proposed. In addition, the HKEx proposes making the establishment of Audit Committees a mandatory requirement, and the establishment of Nomination and Remuneration Committees good practice.

An important aspect of corporate governance is to enhance the transparency of company operations. Effective corporate governance means the disclosure of information that is truthful and timely in reflecting the operations and financial position of the corporation concerned. Such information should also meet the needs of the users (especially investors). It is important to bear in mind that the quality of our accounting and auditing standards and practitioners in the accounting profession has a direct bearing on the quality of the information disclosed.

The Hong Kong Society of Accountants is the self-regulatory body for the accounting profession. It promulgates the accounting and auditing standards in Hong Kong (Statement of Standard Accounting Practices and Statement of Auditing Standards). The President of the Society would explain their work later on. The present system has operated well but there are of course areas for improvement. For example, the SCCLR in its Consultation Paper published last year recommends widening the composition of the relevant accounting and auditing standards setting committees to cater for greater public involvement in the process. We support such recommendations. Furthermore, the SCCLR also recommends establishing a body

with authority to investigate financial statements. We are positively examining this proposal.

In relation to accounting and auditing standards, apart from very rare circumstances, Hong Kong's standards are in line with the International Accounting Standards. The President of the Society would explain the details. In fact the Financial Times carried an article on 26 February 2002, stating that the US accounting standards compare unfavourably with those in Hong Kong in certain areas. For example, the Hong Kong accounting standards do not permit the use of special purpose entities.

The Securities and Futures Ordinance provides auditors of listed companies who report to the SFC any suspected fraud or misconduct in the management of a listed company with statutory immunity from civil liability under the common law. This would encourage auditors working under the rule of professional ethics to discharge their civic duty to report possible fraud or irregularities to the SFC when conducting an audit of a listed company. This help to protect the interest of the investing public.

The measures mentioned above are part and partial of an on-going task to solidify our corporate governance regime. The initiatives were launched by the various agencies and professional bodies well before Enron. The public is being consulted in this evolving process.

Obviously, we cannot rely on legislation alone to enhance corporate governance standards. In fact, the Enron case indicated that such incidents happen even in the States, notwithstanding her stringent legislation and advanced regulatory regime. This illustrates that besides making and enforcing legislation, corporate culture is equally important. By corporate culture, I mean whether companies comply with both the spirit and provisions of the law, whether they recognise the direct impact of corporate governance on the value of their shares, whether they acknowledge their responsibilities to shareholders, employees and creditors, as well as to the general public as a whole. In this regard, in implementing the provisions of law in Hong Kong, we would continue to work closely with the SFC, the HKEx and other professional bodies to instill a good corporate culture amongst companies through public education and publicity campaigns.

Corporate governance is not a sector specific issue. It straddles different sectors and is a subject that should concern directors and senior management of companies, shareholders, regulators and professionals alike. Improving our corporate governance regime is a continuous task, which requires the concerted action and support of all parties concerned. We will work with all relevant parties towards this common goal.

Finally, the rule of law and the independence of judiciary are crucial elements in a successful corporate governance regime. Even with stringent legislation, a water-tight regulatory regime and the professionalism of the practitioners, we can only deter but cannot eliminate fraud completely. In this respect, we rely on Hong Kong's effective law enforcement agencies, our mature legal system and the independent judges who apply the law without fear or favour to punish those who break the law.

End/Thursday, March 14, 2002

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